Yelahanka Lokesh
Dr. Mounica
Vallabhaneni

APPLIED INTERMEDIATE MACROECONOMICS

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CHAPTER 1

ANALYSIS OF MARKETS IN ECONOMICS: STRUCTURE, BEHAVIOR AND PERFORMANCE

Mr. Yelahanka Lokesh
Assistant Professor, Department of Commerce and Economics,
Presidency University, Bangalore, India.
Email Id: lokesh.yr@presidencyuniversity.in

ABSTRACT:

This paper seeks to provide a thorough examination of the economics market. It examines the underlying ideas, essential elements, and dynamics of different kinds of markets. The research looks at market structures, supply and demand variables, pricing theories, and the function of government interventions. Understanding these elements will help consumers, firms, and politicians make wise choices and create winning strategies for navigating the market's intricacies.In order to analyse economic marketplaces, this research project will concentrate on their composition, behaviour, and functionality. Markets are essential to economic systems because they make it easier to trade products, services, and resources. The research investigates the various market structures, such as monopoly, oligopoly, perfect competition, and monopoly, and analyses their features, causes, and effects. It examines market behaviour, including how prices are set, how markets function, and how supply and demand factors play a part. The study also evaluates market performance variables including effectiveness, rivalry, customer welfare, and market power. This research offers insights into the operation of markets, their effectiveness, and the consequences for economic outcomes via empirical analysis, case studies, and theoretical frameworks. The results aid in improving our comprehension of market dynamics and provide information for policies and decisions on market regulation, competition, and efficiency.

KEYWORDS:

Demand, Economics,Government Intervention, Market, Market Structure, Pricing, Supply.

INTRODUCTION

Intermediate Microeconomics:

A Tool-Building Approach provides students seeking degrees in economics or business with a straightforward, calculus-based explanation of contemporary microeconomic theory. The fundamental concepts generally covered at the intermediate level are all included in this wonderfully presented and approachable work, from consumer and producer theory through the market structures of perfect competition, monopoly, duopoly, and oligopoly. General equilibrium, risk, and game theory are further subjects. There are also chapters on externalities, asymmetric knowledge, and public goods.

The book seeks to teach microeconomic theory via a technique of learning-by-doing using numerical examples and activities. A set of steps detailing the method is given when a skill has to be learned, and then an example is given to show how the technique is carried out. Students will be well on their way to learning the abilities required for future study once they can solve issues

comparable to those they have just learnt how to solve.Intermediate Microeconomics condenses a lot of information while maintaining rigour and clarity of explanation. Students who study this book will develop the theoretical groundwork and analytical skills required for upper-level field courses in economics, such as industrial organisation, international commerce, and public finance[1]–[3].

Constructing a Model

Modelling social phenomena is how economics advances. We refer to a model as a condensed portrayal of reality. The word "simple" is highlighted in this sentence. Imagine how worthless a map would be if it were scaled down to one to one. The same holds true for economic models that aim to include all facets of reality. The strength of a model comes from the removal of extraneous material, which frees the economist to concentrate on the key elements of the economic reality they are trying to comprehend.

Here, we're interested in the factors that affect flat prices, thus we need a brief overview of the rental market. The art of selecting the appropriate simplifications while creating a model is complex. In general, we aim to choose the most basic model that can adequately capture the economic scenario we are looking at. The model may then get more sophisticated and, hopefully, more realistic as we add problems one at a time.The flat market in a large college town in the Midwest is the specific example we want to take into account. There are two types of flats in this town. Some of them are close to the institution, while others are further away. Since they provide better access to the university, students tend to see the nearby flats as more attractive. Most students would prefer a local apartment, if they can afford one, since the faraway ones require taking a bus or a protracted, chilly bicycle ride.

The residences will be visualised as being situated in two concentric rings that around the institution. The apartments that are close to one another are in the inner ring, while the others are found in the outer ring. We will just concentrate on the inner ring flat market. If a person is unable to locate one of the nearby flats, they may proceed to the outer ring.An economist would remark that the price of the outer-ring apartments is an exogenous variable, whilst the price of the inner-ring apartments is an endogenous variable, to explain the difference in the prices of the two types of apartments in this model. This indicates that the price of the inner-ring apartments is driven by forces stated in the model, but the price of the outer-ring apartments is assumed to be influenced by causes not covered in this specific model.

The first simplification we'll apply to our model is that, save from location, every flat is the same. Thus, discussing "the price" of flats will make sense without concern for whether they contain one bedroom, two bedrooms, or anything else.But how is this pricing determined? Who gets to reside in the flats in the inner ring and who gets to dwell further out? What can be stated about the viability of various economic methods for distributing apartments? What criteria may we use to evaluate the quality of various flat assignments to people? We want our model to answer each of these queries.

Optimization and Equilibrium

We need a framework on which to base our analyses whenever we attempt to describe human behaviour. We often use a framework in economics that is based on the two simple ideas listed below.The optimization principle states that individuals aim to choose the optimal consumption

habits they can manage.The idea of balance Prices change until the quantity that is provided and the amount that is demanded are equal.Let's think about these two ideas. The first nearly seems to be a tautology. If individuals have the freedom to select their behaviours, it seems to reason that they would strive to pick what they desire as opposed to what they don't want. There are, of course, exceptions to this general rule, but they usually fall beyond the realm of economic behaviour.

The second idea poses a little more of a challenge. It is at least feasible that demand and supply are incompatible at any given moment, which implies that something is changing. It could take a while for these changes to stabilise, and even worse, they might spark more changes that "destabilise" the whole system.Even while anything like this may occur, it typically doesn't. Apartment rental prices often remain quite consistent from month to month. We are interested in this equilibrium price, not in the process by which the market reaches it or in potential long-term changes.It is important to note that various models may utilise different definitions of equilibrium. The demand and supply equilibrium concept will be suitable for our requirements in the scenario of the basic market we shall investigate in this chapter. However, we will need broader definitions of equilibrium in models that are more generic. The activities of the economic actors often need to be consistent with one another for equilibrium to exist.How might the answers to the questions we posed above be determined using these two principles? It's time to discuss some economic ideas.

The Demand Curve

Let's imagine that we ask each potential tenant for an apartment how much money they would be ready to spend, on average, to rent one of the units.= Let's begin from the very top. There must be someone who is prepared to spend the most money. Perhaps this individual is really wealthy, perhaps he is quite lazy and doesn't want to travel too far, or perhaps something else. Let's say the guy is prepared to spend $500 per month for a rental.

If the price of apartments were set at $500 per month, precisely one unit would be rented to the one individual who was willing to pay that amount if there were only one person who was prepared to spend that amount.Assume that $490 is the greatest amount anybody is prepared to pay.If the market price was $499, only one flat would be leased since only those who were prepared to pay $500 would do so, while others who were only ready to pay $490 would not. So it continues. If the price were $498, $497, $496, and so on until we reach a price of $490, just one flat would be leased. Exactly two flats would be leased at that cost, one to the $500 renter and the other to the $490 renter.

Similar to this, we would rent two units until we reached the highest price that the person with the third highest price would be ready to pay, and so on.The utmost price that a person will pay for anything is referred to as their reserve price by economists. The greatest price that a certain buyer will take and still buy the item is called the reserve price. In other terms, a person's reserve price is the amount at which he or she is just undecided about buying or not. In our example, if someone has a reservation price of p, it indicates that they would simply be unable to decide between living in the inner ring for free or paying p to live in the outer ring.

As a result, the number of reservations with a price higher than or equal to p will be the only ones that count towards the number of flats that will be leased at that price. Because everyone who is prepared to spend at least p for a flat will prefer one in the inner ring, while everyone who

isn't willing to pay p will want to live in the outer ring, if the market price is p[4]–[6].These reservation costs may be shown graphically as in Figure 1. Here, the horizontal axis shows the number of persons who are prepared to pay that amount or more, while the vertical axis shows the price.

Figure 1 may also be seen as a measurement of the number of persons who would be interested in renting units at a certain price. Such a curve serves as an illustration of a demand curve, which connects quantity required with price. There won't be any units leased when the market price is more than $500. One flat will be leased when the cost is between $500 and $490. Two units will be booked when the price is between $490 and the next highest reservation price, and so on. The amount demanded at each of the potential prices is described by the demand curve.As flat prices drop, more people will be ready to rent flats, according to the downward-sloping demand curve for apartments. If there are several guests and the costs for each reservation are just marginally different.

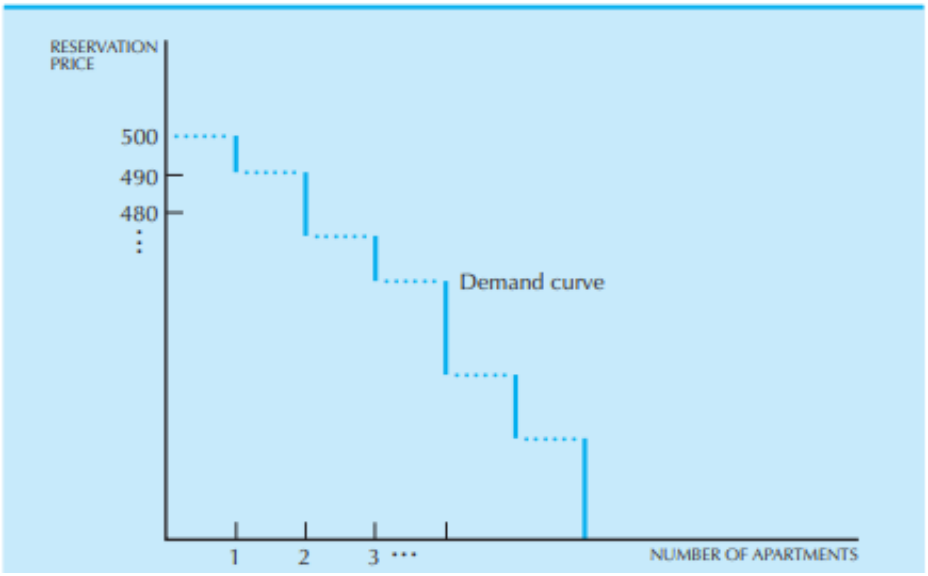

Figure 1: Represents thedemand curve.

The Supply Curve

supply behaviour now that we have seen a great graphical depiction of demand behaviour. Here, we need to consider the kind of market we are looking at. We'll take into account a scenario in which several independent landlords are competing with one another to rent their units for as much as the market will bear. This is what we'll call the instance of a competitive market. There are undoubtedly other viable market configurations.

Let's focus on the scenario where there are several independent landlords for the time being. It seems obvious that the equilibrium price of every flat in the inner ring must be the same if all landlords are doing the best they can and if the tenants are fully aware of the prices the landlords charge. The reasoning is simple to understand. Instead, imagine that there are two prices being charged for apartments: a high price, ph, and a cheap price, pl. The tenants who are paying high rent for their units might approach a landlord who is charging a low rent and propose to pay a

rate that falls between ph and pl. Both the tenant and the landlord would benefit from a deal at that price. A scenario in which multiple prices are being charged for the same product cannot exist in equilibrium to the degree that all parties are attempting to promote their own interests and are aware of the alternative prices being charged.But what will the price of this singular equilibrium be? Let's attempt the approach we used to build the demand curve: we'll choose a price and inquire as to how many units will be delivered at that price.The answer is somewhat influenced by the time period we are using to study the market. The number of units will undoubtedly correspond to the price paid if we are contemplating a time period of many years to allow for fresh building.If we merely take into account this short-run scenario, the supply of flats will remain constant at a certain level.

Comparative Statics

A model of the economics of the flat market, we can use it to study how the equilibrium pricing behaves. For instance, we may investigate how changing market conditions affect flat prices. Comparative statics is the term for this kind of exercise because it compares two "static" equilibria without It might take a long time to transition from one equilibrium to another, thus it can be highly intriguing and crucial to understand how this happens. However, we must first walk in order to run, so we will put such complex problems off for the time being. Only equilibria are compared in comparative statics analysis, hence there are currently sufficient problems to be answered within this framework.

Given that the supply has decreased, your first assumption is presumably that flat prices would increase. However, this may not always be the case. It is true that there are fewer rental flats available. However, since some of the individuals who were renting flats could choose to buy the new condos, the demand for apartments has also decreased.It is reasonable to suppose that individuals who buy condominiums are those who now reside in inner-ring apartments and are prepared to spend more than p for an apartment. Let's say, for instance, that the ten demanders with the highest reservation costs choose to purchase condominiums rather than rent housing. The previous demand curve then remains unchanged with 10 less demanders at each price, resulting in the new demand curve. The new equilibrium price is the same as it was before, and the same individuals end up residing in the innerring flats since there are also 10 fewer units available for rent. The supply and demand curves both move left by 10 apartments, but the equilibrium price does not change[7]–[9].

They often focus only on the decline in flat supply while ignoring the decline in flat demand. The scenario we've looked at is an extreme one all of the condo buyers previously lived in apartments. However, the alternative scenario where none of the condo buyers lived in apartments—is much more severe.Despite its simplicity, the model has helped us reach a critical understanding. We must take into account both the impact on the supply and demand of flats if we want to understand how conversion to condos will influence the apartment market.Take the impact of a flat tax as yet another illustration of a startling comparative statics study. Let's say the municipal council determines there should be a $50 annual tax on flats. As a result, each landlord will be required to provide the city $50 annually for each flat he owns.Most people would assume that flat tenants would pay at least a portion of the tax. Surprisingly, however, that is not the case.In actuality, the equilibrium cost of flats won't change.We need to find out what happens to the supply and demand curves in order to confirm this. There are the same number of units after the tax as there were before it, therefore the supply curve remains unchanged. Additionally,

the demand curve stays the same since the same number of flats will be leased at each different price. The price cannot change due to the tax if neither the supply curve nor the demand curve alters.

Here is a technique to consider how this tax will have an impact. Each landlord sets his rent as high as he can before the tax is implemented in order to maintain tenants in his flats. The greatest price that may be demanded while still being acceptable with every flat being leased is known as the equilibrium price, or p. Can landlords boost their rates to cover the tax once it is implemented? No, they wouldn't have already done so if they could increase the price and maintain occupancy in their flats. The landlords couldn't increase their rates if they were already charging what the market would bear since no tax could be passed on to the tenants. The full tax is the responsibility of the landlords[10].The supply of flats will continue to be fixed, which is the underlying premise of this research. Renters' costs will often alter if the number of flats may change along with tax adjustments. We'll look at this kind of behaviours later, when we've developed some more robust tools for looking at issues of this nature.

CONCLUSION

Economics' examination of markets exposes their complexity as well as the key elements that have a significant impact on how they operate. Market structures including monopoly, oligopoly, perfect competition, and monopolistic competition influence how businesses behave and how much competition exists in a given industry. To forecast market outcomes and set prices, it is crucial to comprehend demand and supply dynamics. The equilibrium price and quantity in a market are mostly determined by pricing mechanisms, such as price elasticity, cost-based pricing, and market-based pricing. To maximize profitability and adapt to changing market circumstances, organizations must take into account these elements when determining price.grasp how markets operate, behave, and perform requires a thorough grasp of economics. For the purpose of fostering competitive markets, guaranteeing efficiency, and attaining desirable economic results, ongoing research, empirical analysis, and governmental interventions are essential. The productivity, creativity, and consumer welfare of economies may increase through promoting competitive and efficient marketplaces.

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CHAPTER 2

DETERMINANTS OF DEMAND AND SUPPLY

Dr. Dasinis Nathan Annette Christinal
Assistant Professor,Masters in Business Administration (E-Commerce),
Presidency University, Bangalore, India.
Email Id: annette.c@presidencyuniversity.in

ABSTRACT:

The factors that affect supply and demand in economics. It examines the important variables that affect both the amount of products and services that customers desire and the quantity that producers provide. To analyse market dynamics, forecast price changes, and make wise judgements in the commercial and policymaking spheres, it is essential to comprehend these factors.The goal of this study is to examine the variables that affect market forces in economic systems and analyse the elements that determine supply and demand. Understanding market dynamics, price formation, and resource allocation all depend on knowing what drives supply and demand. The research looks at the major factors affecting demand, such as consumer preferences, income, the cost of associated items, and demographic information about the population. It also looks at factors that affect supply, such the price of manufacturing, technological advancements, the accessibility of resources, and governmental rules. The study also examines the relationships between supply and demand and how modifications to these drivers impact market equilibrium. This research offers insights into the elements influencing market forces and educates evidence-based decision-making and policies relating to market dynamics, pricing, and resource allocation via empirical analysis, case studies, and theoretical frameworks.

KEYWORDS:

Consumers, Demand, Determinants,Market DynamicsProducers, Market Dynamics, Supply.

INTRODUCTION

introductory session that the market demand for any commodity relies on a number of factors besides the price of that thing. These include (a) the prospective customers' income levels, (b) the cost of competing products, (c) the tastes or preferences of customers, and (d) the total number of customers. The market demand curve shifts when one of these drivers changes while the other variables remain unchanged. Demand is said to rise during a rightward shift and fall during a leftward shift.We say a good has a positive income impact when a rise in buyer income levels results in an increase in demand consumers purchase more of the product regardless of price level. A normal good is one that has a positive income impact. On rare cases, the converse may take place: a good may have a detrimental impact on revenue. For instance, it's feasible that customers with low earnings may lower their use of inexpensive, fatty red meat when their wages rise, perhaps by moving to more costly lean cuts or chicken.

A product like this is referred to be an inferior good since the demand for it swings to the left as earnings grow. The cost of comparable products, such as alternatives and complements, has an impact on the demand for a given commodity. Increased demand for the item under

consideration would result from people purchasing more of the alternative product as its price rose. A complement's price rise will probably result in less people wanting to buy it[1]–[3].On the supply side, the availability of any item on the market is mostly determined by (a) the cost of the inputs used to produce it, (b) the technology used in its production, and (c) the number of businesses. Any one of these factors may alter, leading to an increase or reduction in supply. Therefore, a technological advancement that increases input productivity or an increase in the number of businesses are likely to result in an increase in supply, or a rightward shift of the supply curve. The opposing effect of a price rise on an input would be a reduction in supply or a leftward supply shift.

Market Interventions

We review some of the information from an introductory microeconomics course on market interventions in this part. Price restrictions, quantity limits (or quotas), and taxes or subsidies are the three forms of interventions that may be used at the municipal, state, or federal levels. We demonstrate this for a market for generic products whose inverse supply and demand curves are provided by:

$$p = 24 - Q^d \quad \text{and} \quad p = 3 + 0.5Q^s.$$

Price ceilings

A product's maximum price is set by a price ceiling (also known as a price cap). For instance, price regulation in the US (and many other nations) sets a limit on the cost per unit of power used by residential users. This amount must be below the equilibrium market price in order for a price limit to be effective or legally enforceable, as shown by p = 8 in At this price, there is excess demand, which means that there are more buyers than there are sellers who are ready to sell. As a result, the vendors must practise rationing.

Rationing is a strategy for selecting which of the many buyers to sell to. For instance, a landlord may opt to rent out flats in rent-controlled housing on a first-come, first-served basis.Keep in mind that part of the demand will always remain unsatisfied, therefore a contractual price cap creates an unbalanced market. Assuming effective rationing, buyers distribute the item according to greatest willingness to pay, which creates a consumer surplus of $110 (shown by area A) and a producer surplus of $25 (represented by area B) The sum of the current regions A and B, or the total profits from trading, is $135; however, this amount is $12 less than the benefits from trade before the price limit, or the area C. Area C, which is known as the "deadweight loss of a price ceiling," here depicts the decline in trade profits as a consequence of the ceiling. A deadweight loss is a sign of inefficiency in the market.

Pareto Efficiency

Economic efficiency, often known as Pareto efficiency, is a helpful metric for contrasting the results of various economic regimes.1 We begin by defining a Pareto improvement as one in which some individuals may be made better off without causing anybody else to be worse off. An allocation is referred to be Pareto efficient if it prevents any potential Pareto improvements, and Pareto inefficient if it permits such improvements.The unfavourable aspect of a Pareto inefficient allocation is that there is a means to benefit one person without harming others. The allocation may have other advantages, but the fact that it is Pareto inefficient is undoubtedly a drawback. Why not do it if there is a means to improve someone's situation without harming

others?We will go into more depth later on, but Pareto efficiency is a key concept in economics. We will have to study its many complex ramifications more cautiously, but we can already get a sense of what is at stake.

Here is a helpful perspective on the Pareto efficiency concept. The tenants could sublease their flats to one another if we choose at random which ones were in the inner and outer rings.Some folks who truly wanted to live nearby can unluckily wind up with a flat on the outer ring. Then then, they could be able to sublease an inner-ring flat from a tenant who was allocated to one but didn't appreciate it as much as the other tenant did. If people were randomly allocated to flats, some people would likely wish to switch apartments if they were given enough money to do so.

Consider the following scenario: Let's say that person A is given a flat in the inner ring that he believes is worth $200, and that person B in the outer ring is ready to pay $300 for A's flat. If these two agents switch residences and work out a side payment from B to A of anywhere between $200 and $300, there is a "gain from trade" in that case.The transaction's precise dollar value is unimportant. The most valuable buyers of the flats should be the ones who end up with them; otherwise, there would be a motivation for someone who assigned a low value to an inner-ring apartment to exchange with someone who added a high value to an inner-ring apartment.Assume that we consider all voluntary deals to be completed in such a way as to exhaust any trade-related profits. The allocation that results must be Pareto effective. If not, some deal would be made that would benefit two individuals without harming anybody else, but this would go against the notion that only voluntary exchanges had taken place. A Pareto efficient allocation is one in which all voluntary exchanges have been completed.

DISCUSSION

Comparing Ways to Allocate Apartments

Since the trading procedure we've just described is so all-encompassing, you may assume that not much can be said about how it turns out. There is, however, one extremely intriguing issue that might be raised. Let's consider who will get units in an allocation once all trade benefits have been used up.Simply take notice of the fact that everyone who owns an apartment in the inner ring must have a higher reservation price than everyone who owns an apartment in the outer ring, since doing so would result in a trade that would benefit both parties. As a result, if there are S available flats for rent, the S individuals who made the highest reservation rates end up receiving units in the inner ring. Any other distribution would allow for a deal that would benefit at least two of the persons without harming anybody else, making it less Pareto efficient than this distribution.

Let's attempt to apply this Pareto efficiency criterion to the results of the different resource allocation strategies stated above. Let's begin by discussing the market mechanism. It is clear that the market process places individuals with the S highest reservation prices in the inner ring, i.e., those who are prepared to pay higher prices for their flats than the equilibrium price, p. As a result, after the units have been leased in a market with strong competition, there are no further trading benefits to be acquired. Market competition produces Pareto efficient results[4]–[6].What about the monopolist who is selective? Is that configuration Pareto efficient? Simply note that the discriminating monopolist gives flats to the exact same persons who obtain apartments in the competitive market to provide an answer to this question. Everybody who is ready to spend more than p for a flat receives one under each arrangement. As a result, the discriminating monopolist

also produces a result that is Pareto efficient.Both a competitive market and a discriminating monopolist provide Pareto optimal results in the sense that no more transactions will be wanted, but they may also lead to very different income distributions. Without a doubt, the landlord(s) benefit far more from the discriminating monopolist than the consumers do from the competitive market. Generally speaking, Pareto efficiency doesn't have much to say about how trade-related profits are distributed. It solely cares about the effectiveness of the deal, or if all potential trades have been completed.

How about the typical monopolist, who is only allowed to set one price? As it happens, this circumstance is not Pareto efficient. The only way to confirm this is to observe that because the monopolist will not typically rent all the flats, he may improve his earnings by renting an apartment to someone who lacks one at any favourable price. There is a certain cost where the monopolist and the renter must both benefit more. The other tenants are in the same financial situation as they were before, provided that the monopolist does not alter the price that anybody else must pay. Thus, we have discovered a Pareto improvement a technique to benefit two parties without harming anybody else.

Rent control is the last example. Also, it turns out that this is not Pareto efficient. The basis of this defence is that a random distribution of renters across apartments would often entail a resident of the inner ring (let's say Mr. In) who is ready to pay less for an apartment than a resident of the outer ring (let's say Ms. Out). Assume the reservation costs for Mr. In and Ms. Out are $300 and $500, respectively.Finding a Pareto improvementa strategy to enhance the situation of Mr. In and Ms. Out without harming anybody elseis necessary. However, there is a simple solution—just allow Mr. In to lease his flat to Ms. Out. Living near to the university is worth $500 to Ms. Out but just $300 to Mr. In. 6They will both benefit if Ms. Out pays Mr. In $400 and exchanges apartments, for example. Mr. In will get $400 that he values more than an inner-ring apartment, while Ms. Out would receive an apartment that she values above $400.This illustration demonstrates that a rent-controlled market will often not lead to a Pareto optimal allocation since transactions may still be made after the market has functioned. There will always be profits from trading as long as some individuals get inner-ring flats and value them less than others who do not.

Equilibrium in the Long Run

The supply curve calculates the number of apartments that will be provided at various prices, just as the demand curve calculates the number of units that will be wanted at various prices. The combination of supply and demand will ultimately determine the market price for flats.What, moreover, governs the supply behaviour? Generally speaking, how many new flats the private sector will provide will depend on how lucrative it is to offer apartments, which relies in part on the rent prices that landlords may set. We will finally do the job of looking at both the behaviour of providers and demanders in order to analyse the behaviour of the flat market over time.When there is a fluctuating supply, it is possible to speculate on who will get flats as well as how many will be offered by different market institutions. Will a monopolist create more or fewer units than a market where there is competition? Will the equilibrium number of flats change as a result of rent control? Which organisations will provide the most flats in Pareto? We must create more methodical and powerful economic analytical tools in order to respond to these and comparable problems.

Budget Constraint

The basic tenet of economic theory about customers is that people choose the best combination of items they can afford. This hypothesis needs more substance, therefore we must be more specific about what we mean by "best" and "can afford."

The Budget Constraint

We start by looking at the idea of a budget limitation. Assume that the customer has a selection of things from which to pick. Although there are numerous commodities to be consumed in real life, for our purposes it is more easy to merely examine the scenario of two items since this allows us to visually represent the consumer's choosing behaviour. By (x1, x2), we will show the consumer's consumption bundle. This is only a list of two numbers that indicate how much the consumer is choosing to eat of good 1 and good 2, respectively. The consumer's bundle may sometimes be shown by a single symbol, such as X, which is only an acronym for the list of two integers (x1, x2).We assume that we can see the costs of the two commodities, (p1, p2), as well as the consumer's financial constraints, m. The consumer's financial limitations might therefore be expressed. We start by looking at the idea of a budget limitation. Assume that the customer has a selection of things from which to pick. Although there are numerous commodities to be consumed in real life, for our purposes it is more easy to merely examine the scenario of two items since this allows us to visually represent the consumer's choosing behaviour.By (x1, x2), we will show the consumer's consumption bundle. This is only a list of two numbers that indicate how much the consumer is choosing to eat of good 1 and good 2, respectively. The consumer's bundle may sometimes be shown by a single symbol, such as X, which is only an acronym for the list of two integers (x1, x2)[7]–[9].

We assume that we can see the costs of the two commodities, (p1, p2), as well as the consumer's financial constraints, m. therefore, the consumer's limited incomeHere, p1x1 represents the total of the consumer's expenditures on Good 1 and p2x2 represents the sum of the consumer's expenditures on Good 2.Due to the client's financial limitations, the cost of the two items must not exceed the total amount the consumer may spend. The consumption bundles that are within the consumer's price range are those that do not exceed m. We refer to this collection of affordable consumption bundles at prices (p1, p2) and income m as the consumer's budget set.

Two Goods Are Often Enough

Since we often interpret one of the commodities as reflecting everything else the buyer would desire to consume, the two-good assumption is more comprehensive than you might first expect.For instance, if we wanted to investigate a consumer's milk demand, we might have x1 record their milk intake in quarts each month. Then, we can use x2 to represent whatever else the customer could desire to consume. When using this interpretation, it is appropriate to consider good 2 to be the money that the customer may use to purchase additional goods.According to this understanding, because the price of one dollar is one dollar, the price of good two will naturally be one. Consequently, the budgetary restriction will manifest as[10]

This statement simply states that the entire amount of money the customer has available to spend, denoted by the letter m, cannot be more than the sum of the amounts spent on products 1 and all other items combined, or p1x1 and x2, respectively.We argue that good stands for a composite good that encapsulates all possible alternatives to good that the customer could choose

to consume. Such a composite product is always valued in terms of money that may be used to purchase items besides good 1. Everything we have to say about the budget restriction in general will still hold true under the composite-good interpretation as equation is essentially a specific instance of the algebraic formula provided in equation with p2 = 1.

CONCLUSION

Demand and supply dynamics have a significant role in determining the equilibrium price and quantity of products and services as well as market dynamics. For firms, governments, and consumers to make educated choices and forecast market outcomes, an understanding of these drivers is crucial. Demand is influenced by a number of variables, including consumer preferences, income levels, related-goods pricing, population statistics, and customer expectations. Any of these variables may change, causing shifts in the demand curve and changes in the amount of products and services sought. For instance, an increase in consumer income can cause a rise in the demand for specific luxury products, whilst a drop in the cost of a suitable equivalent would cause a decline in that demand.grasp market dynamics and resource allocation requires a grasp of the factors that determine supply and demand. The goal of this research project was to examine the variables that affect market forces and the elements that determine supply and demand.According to the research, factors that affect demand include consumer preferences, income levels, the cost of associated items, and demographics of the population. Demand for different kinds and quantities of products and services is influenced by consumer preferences and tastes. Consumers' buying power and inclination to spend money on various goods are influenced by their income levels. The pricing of comparable items, such as alternatives or complements, has an impact on a product's demand. Demand patterns are influenced by population demographics, such as age, income distribution, and population size.

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CHAPTER 3

INVESTIGATION OF TAXES, SUBSIDIES AND RATIONINGIN FIELD OF MACROECONOMICS

Dr. Mounica Vallabhaneni
Assistant Professor,Department of Commerce and Economics,
Presidency University, Bangalore, India.
Email Id: mounicav@presidencyuniversity.in

ABSTRACT:

The ideas of taxes, subsidies, and rationing and how they affect the dynamics of the market. It looks at how governments and policymakers employ these economic instruments to affect market outcomes, distribute resources, and correct market imperfections. To make wise choices and support the efficient and fair operation of the market, firms, politicians, and consumers must understand the impacts of taxes, subsidies, and rationing.Governments utilise axes, subsidies, and rationing as effective instruments to affect market results, resource allocation, and social welfare. The research looks at how taxes affect consumer behaviour, market performance, and tax income. Additionally, it examines how subsidies affect social equality, producer incentives, and market dynamics. The study also examines how rationing affects resource distribution in times of shortage or emergency. This research offers insights into the outcomes of various interventions and supports the creation of evidence-based taxation, subsidy, and resource allocation policies via empirical analysis, case studies, and economic models.

KEYWORDS:

Allocation, Market Failures. Rationing, Subsidies, Taxes Resource Allocation.

INTRODUCTION

Taxes and other instruments used in economic policy often have an impact on consumer budget constraints. For instance, if the government levies a quantity tax, the customer will be required to pay the government a set amount for each unit of the commodity he purchases. For instance, we pay a federal petrol tax of roughly 15 cents per gallon in the United States.What impact does a quantity tax have on a consumer's budget? From the consumer's perspective, the tax is equivalent to a higher price. The price of good 1 is therefore changed from p1 to p1 + t by a quantity tax of t dollars per unit. This suggests that the budget line must get steeper, as we've seen above.Value taxes are yet another kind of tax. As the name suggests, this tax is levied on the price, not the amount bought, of an item. Value taxes are often stated as percentages. The majority of American states impose sales taxes. A product that is priced at $1 will actually sell for $1.06 if the sales tax is 6%. Ad valorem taxes are another name for value taxes.

The real amount that the customer will pay is (1 +)p1 if good 1 has a price of p1 but is subject to sales tax at rate.For each unit of the item, the customer must pay P1 to the provider and P1 to the government, making the total cost to the consumer P1 (1 + P1).A tax's opposite is a subsidy. In the event of a quantity subsidy, the government provides the customer with a payment that is

based on the quantity of the commodity they have bought. For instance, if milk consumption were subsidised, the government would give each customer a certain number of money based on how much milk they bought. From the perspective of the customer, the price of good 1 would be p1 s if the subsidy is s dollars per unit of consumption of good 1. As a result, the budget line would become flatter.Ad valorem subsidies are also dependent on the cost of the product being subsidised. Your charitable contributions are being subsidised by 50% if the government pays you back $1 for every $2 you contribute to charity. In general, the real price of an item confronting the customer is (1)p1 if the price of the good is p1 and the good is subject to an ad valorem subsidy at rate[1]–[3]. The government may also levy a lump sum tax or provide a lump amount subsidy. This is a tax in which the government withholds a certain amount of money whatever the actions of the taxpayer. Therefore, a lump-sum tax indicates that a consumer's budget line would move inside since his monetary income has decreased. Similar to a lump amount subsidy, an outward change in the budget line is implied.

Budget Line Changes

The customer selects an ideal consumption bundle based on the constraints of their budget. However, we may already make some conclusions based on what we know about the budget line's changes.First, we can see that because the budget set is constant when all costs and revenue are multiplied by a positive amount, the best option for the customer within the budget set is also constant. We have reached a crucial conclusion without even considering the decision process itself: a perfectly balanced inflation one in which all prices and incomes increase at the same rate doesn't affect anyone's budget set and, thus, cannot affect anyone's optimum choice.

Second, we may draw some generalisations about the consumer's potential wealth at various prices and income levels. Assume that the consumer's income rises but that no prices change. We are aware that this entails a simultaneous expansion of the budget line. As a result, any package the client purchased when they had lower incomes is now an option for them when they have larger incomes. However, because the consumer has more options than before, it follows that they must be at least as well-off at the greater income as they were at the lower income. Similar to this, the customer must be at least as wealthy if one price decreases but all others remain the same.

DISCUSSION

Consumer Preferences

We'll assume that the consumer may rank any two consumption bundles, (x1, x2) and (y1, y2), according to their attractiveness. In other words, the consumer has the option of deciding that one of the consumption bundles is objectively superior to the other or that she could not care less about either bundle.The symbol (x1, x2) (y1, y2) should be understood to signify that the consumer strongly prefers (x1, x2) to (y1, y2), in the sense that she certainly wants the x-bundle rather than the y-bundle. We shall use the symbol to denote that one bundle is rigorously preferred to another. It is intended that this preference connection be an operational idea. If a customer likes one bundle over another, it suggests that, given the choice, he or she would choose the preferred bundle. Thus, consumer behaviour serves as the foundation for the concept of preference. We observe how the customer acts in scenarios where they must choose between the two bundles in order to determine which one is preferable. It is reasonable to assume that this customer prefers (x1, x2) over (y1, y2) if she consistently picks (x1, x2) over (y1, y2).

When a customer cannot decide between two product bundles, we utilise the symbol and write (x1, x2) (y1, y2). ingesting the bundles (x1, x2) would leave the consumer as happy in terms of her preferences as would ingesting the other bundle (y1, y2). This is what is meant by indifference.When a customer chooses one of the two bundles over the other or is unsure, we remark that she weakly prefers (x1, x2) to (y1, y2) and write (x1, x2) (y1, y2).These relationships between stringent preference, weak preference, and indifference are really connected; they are not separate notions! For instance, we may deduce that (x1, x2) (y1, y2) if (x1, x2) (y1, y2) and (y1, y2) (x1, x2). That instance, if the customer believes that both (x1, x2) and (y1, y2) are at least as good as (x1, x2), then the buyer must not care which of the two bundles of products they choose.

Assumptions about Preferences

The "consistency" of customer choices is a topic on which economists often base their predictions. For instance, it seems illogical not to mention contradictoryto have a scenario in which (x1, x2) (y1, y2) and (y1, y2) (x1, x2) are both true at the same moment. As a result, the customerwould be stating that they strictly prefer the x-bundle over the y-bundle, and vice versa.Therefore, we often assume certain things about how preference interactions function. We might refer to some of the basic preferences presumptions as "axioms" in consumer theory. These three customer preference axioms are provided.Complete. We take for granted the comparability of any two bundles. To put it another way, given any x-bundle and any y-bundle, we presume that (x1, x2) (y1, y2), or (y1, y2) (x1, x2), or both, in which case the consumer is agnostic about the two bundles.

Reflexive. Assuming all bundles are at least as excellent as themselves, we write (x1, x2) (x1, x2).Transitive. We suppose that (x1, x2) (z1, z2) if (x1, x2) (y1, y2) and (y1, y2) (z1, z2). In other words, if a customer believes that X is at least as excellent as Y and that Y is at least as good as Z, then X is at least as good as Z, according to this logic. At least in relation to the kind of decisions economists often study, the first axiom, completeness, is rarely debatable. Simply said, to claim that any two given bundles may be compared is to suggest that the buyer has a choice between any two specific bundles. Ranking the alternatives in severe circumstances involving life or death may be challenging or even impossible, but these decisions are often beyond the purview of economic research.

Reflexivity, the second postulate, is unimportant. Any package is undoubtedly at least as excellent as one that is exactly the same. While it's possible for parents of young children to sometimes see behaviour that defies this presumption, it appears feasible for the majority of adult behaviour.Transitivity, the third axiom, presents significant difficulties. Transitivity of preferences may not be a quality that preferences would always need to have. On the basis of pure reasoning alone, the presumption that preferences are transferable doesn't seem plausible. Actually, it isn't. Transitivity is not a statement of pure logic; rather, it is a theory about how humans make decisions.[4]–[6]

Indifference Curves

It turns out that the three axioms mentioned above, together with a few additional technical assumptions, may be used to construct the whole theory of consumer choice in terms ofpreferences. However, we will find it useful to represent preferences visually by using an apparatus called an indifference curve which shows two axes that indicate a consumer's

consumption of items 1 and 2. Let's choose a certain consumption bundle (x1, x2) and shade in all of the bundles that are just marginally favoured to it. The weakly favoured set is what we have here. The bundles that are equally as indifferent to (x1, x2) for the customer as those on the set's border make up the indifference curve.

Any consumption bundle may have an indifference curve traversed through it. All product bundles that make the customer indifferent towards the specified bundle make up the indifference curve via a consumption bundle.One drawback of utilising indifference curves to depict preferences is that they only display bundles that the consumer believes to be unrelated to one another; they do not display bundles that are better or worse. It might be helpful to mark the preferred bundles' directions with little arrows on the indifference curves.While we won't always do this, we will in a select instances when it might cause misunderstanding. If we do not make any additional preferences assumptions, indifference curves may actually assume quite strange forms. An fundamental property concerning indifference curves, however, may be stated even at this level of generality: indifference curves reflecting different degrees of desire cannot intersect.

One of the bundles, say X, is strictly preferred to the other bundle, Y, according to the premise that the indifference curves indicate different degrees of liking. Since we are aware of X Z and Z Y, the principle of transitivity requires that X Y. However, this defies the presumption that X Y. The conclusion that indifference curves expressing different degrees of desire cannot cross—is established by this paradox.What further characteristics do difference curves possess? The answer is: not many, in the broadest sense. Preferences may be described using indifference curves.Indifference curves may be used to represent almost any set of "reasonable" desires. Learning which preferences lead to certain indifference curve forms is the challenge.

Perfect Substitutes

If the customer is willing to exchange one product for the other on a consistent basis, then two goods are perfect replacements. Perfect replacements are easiest to use when the customer is willing to replace the items one for one.Imagine, for instance, that the customer in question loves pencils but has no preference for colour when faced with a choice between red and blue pencils. Choose a consumption package, such as (10, 10). Then any other consumption bundle containing 20 pencils is equivalent to (10, 10), in the eyes of this consumer. Any consumption bundle (x1, x2) with $x1 + x2 = 20$ will, mathematically speaking, be on this consumer's indifference curve through (10, 10). Increasing preference is up and to the right because bundles with more total pencils are preferred over bundles with less total pencils.

What is the usual process for drawing difference curves like with this? How much of the second good needs to change if we start at (10, 10) and add one unit to the first to make it 11, in order to return to the initial indifference curve? The obvious solution is that we must reduce the second good by one unit. As a result, the slope of the indifference curve across (10, 10) is 1. Any bundle of products may be subjected to the same technique with the same outcomes; in this instance, all indifference curves have a constant slope of 1. The fact that the indifference curves for perfect replacements have a constant slope is crucial. Imagine, for instance, if we plotted pairs of red pencils on the horizontal axis and blue pencils on the vertical axis.Since the customer would be prepared to forego two blue pencils in exchange for one additional pair of red pencils, the slope of the indifference curves for these two products would be equal to 2.

Perfect Complements

Products that are consistently eaten together in certain ratios are considered perfect complements. The products "complement" one another in various ways. The difference between right and left shoes is a good illustration. Although the buyer like shoes, he or she always pairs the right and left shoes. Having only one shoe from a pair serves the customer absolutely no favour.The indifference curves for perfect complements should be drawn. Let's say that we choose the consumption bundle (10, 10). Now that we have 11 and 10, add 1 additional right shoe. By implication, this renders the customer indifferent to the initial stance: the additional shoe doesn't help him. If we add one more left shoe, the same thing takes place: the customer is equally unconcerned about (10, 11) and (10, 10).The direction of growing preference is once again up and to the right, as shown in the figure, and will take the consumer to a more desired position if both the number of left shoes and the number of right shoes are increased at the same time[7]–[9].Perfect complements are crucial because consumers desire to eat the products in certain ratios, not necessarily because they are consumed one to one. The indifference curves will still be L-shaped if a customer constantly adds two teaspoons of sugar to her cup of tea and never uses sugar for anything else. Instead of (1 right shoe, 1 left shoe), (2 right shoes, 2 left shoes), and so on, the corners of the L will appear at (2 teaspoons sugar, 1 cup tea), (4 teaspoons sugar, 2 cups tea), and so on.

Bads

A terrible product is one that the customer dislikes. Assume, for instance, that the goods in issue are now pepperoni and anchovies, and that the customer prefers pepperoni but not anchovies. But imagine that pepperoni and anchovies might be traded off in some way. In other words, there would be enough pepperoni on a pizza to make up for the fact that there would also be a certain number of anchovies. Choose a bundle (x1, x2) that contains pepperoni and anchovies.What must we do with the pepperoni if we offer the customer extra anchovies to maintain him on the same indifference curve? It goes without saying that we have to give him some additional pepperoni to make up for the anchovies[10].

CONCLUSION

Governments and politicians utilise taxes, subsidies, and rationing as economic instruments to influence market outcomes, distribute resources, and correct market failures. Each of these instruments affects market dynamics differently and may change how producers and consumers act. Governments impose taxes on products, services, and income to raise money and affect consumer behaviour. By raising the cost of specific products, they may be used to deter use while also supporting public infrastructure and services. Taxes may also result in unforeseen outcomes like market distortions or a decline in consumer buying power.Governments use xes, subsidies, and rationing as effective instruments to affect market outcomes, resource allocation, and social welfare. This research study set out to examine the implications of these actions and the related policy issues.The impact of taxes on market dynamics, consumer behaviour, and government income is substantial. Taxes may affect consumer demand for products and services, provide incentives or disincentives for certain behaviours, and give the government a source of income. Depending on how they are made, including the tax rate, basis, and structure, taxes have different effects.

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CHAPTER 4

DETERMINATION OF UTILITY: ANALYZING CONSUMER PREFERENCES AND DECISION-MAKING

Mr. Yelahanka Lokesh
Assistant Professor, Department of Commerce and Economics,
Presidency University, Bangalore, India.
Email Id: lokesh.yr@presidencyuniversity.in

ABSTRACT:

The determination of value in economics is the main topic of this essay. Utility is the subjective pleasure or advantage that people experience as a result of using products and services. The notions of total utility, marginal utility, and the variables affecting utility determination are all explored in the research. For the purpose of analysing consumer behaviour, making logical decisions, and forecasting market demand, utility must be understood.The purpose of this study is to analyse how value is determined and to comprehend the variables that affect consumer preferences and decision-making. A key idea in economics is utility, which quantifies the joy or pleasure people get from using products and services. The research looks at different value measurement theories and methods, such as cardinal and ordinal utility, and their effects on consumer behaviour. It looks at the variables that affect utility, such as cost, income, taste, and preferences, and it looks at how these variables affect how consumers make decisions. The study also examines how utility functions in economic models like utility maximisation and consumer demand theory. This research offers insights into utility determination and its consequences for consumer behaviour and market outcomes via empirical analysis, experimental experiments, and theoretical frameworks.

KEYWORDS:

Consumer Behavior, Determination, Goods, Market Demand, Marginal Utility, Satisfaction, Subjective.

INTRODUCTION

Philosophers and economists in the Victorian period casually discussed "utility" as a measure of a person's general well-being. Utility was seen as a quantitative indicator of pleasure. In light of this concept, it was only reasonable to imagine customers making decisions in an effort to maximise their utility, or to make themselves as content as possible.The issue is that these traditional economists never fully explained how we should assess utility. How are we expected to measure the "amount" of utility connected to various options? Is the usefulness of one individual the same as that of another? What would it imply if I said that an additional candy bar would be twice as useful to me as an additional carrot? Does the idea of utility have any other independent meaning except what humans want to maximise? Because of these conceptual issues, economists have given up on the traditional idea that utility is a good indicator of pleasure. Instead, consumer preferences have been used to completely reframe the notion of consumer behaviour, with utility serving only as a means of describing preferences. Gradually,

economists came to understand that, in terms of decision behaviour, the only thing that mattered regarding utility was whether one bundle had a greater value than another—how much higher didn't actually matter.

A bundle (x1, x2) was preferred over a bundle (y1, y2) if the x-bundle had a greater utility than the y-bundle. Originally, preferences were described in terms of utility. But these days, we often consider things in the opposite order. Utility is only a technique of defining preferences, and consumer preferences are the basic description relevant for analysing choice[1]–[3].

Every potential consumption bundle may be given a number using a utility function, and the more preferred bundles are given higher numbers than the less desired ones. In other words, a bundle of symbols (x1, x2) is preferred over a bundle of symbols (y1, y2) if and only if the utility of (x1, x2) is greater than the utility of (y1, y2). The sequence of the bundles of products is the sole aspect of a utility assignment that matters. The amount of the utility difference between any two consumption bundles is irrelevant; the magnitude of the utility function is only significant inasmuch as it ranks the various consumption bundles.This kind of utility is known as ordinal utility due to the focus on arranging bundles of items. Take for instance, where we show numerous possible methods to allocate utilities to three bundles of products while maintaining the same order throughout. The customer in this scenario prefers A to B and B to C. The fact that A is given a higher value than B, who in turn is given a higher number than C, makes all of the approaches described genuine utility functions that express the same preferences.

Cardinal Utility

Some utility theories give the utility's size a special relevance. The term "cardinal utility theories" refers to them. The extent of the value difference between two bundles of commodities is thought to be significant in a theory of cardinal utility. By giving a particular individual an option between the two bundles of commodities and seeing which one is selected, we are able to determine if they prefer one bundle of things over the other. We just provide a greater utility to the selected bundle than to the rejected bundle so that we know how to assign an ordinal utility to the two bundles of products. This makes every assignment that performs it a utility function. As a result, we have an operational criterion for deciding whether a bundle is more useful to a certain person than another bundle.

But how can we know whether someone prefers one bundle over another by a factor of two?How would you even know if you like one bundle over another twice as much?For this kind of task, there are several definitions that might be suggested, such as: I like a bundle twice as much as another if I am prepared to spend twice as much for it. Or, if I'm ready to wait twice as long, run twice as far, or risk twice as much for a bundle, I like it twice as much as another.None of these definitions are incorrect; they all would lead to a method of determining utility levels where the size of the numbers given had some practical importance. However, they also don't have a lot going for them. None of them seems to be a very persuasive reading of that sentence, even if each of them is a viable interpretation of what it means to desire something twice as much as anything else.What use would it be to describe decision behaviour even if we did manage to assign utility magnitudes in a manner that looked extremely compelling? We merely need to know which bundle is preferred which provides the most utility to determine which will be picked. Knowing how much bigger doesn't improve our depiction of choice in any way. We shall remain with a solely ordinal utility framework since cardinal utility is not required to characterise decision behaviour and there is no convincing mechanism to assign cardinal utilities anyhow.

Constructing a Utility Function

However, can we be certain that there is a method for allocating ordinal utilities? Can we always discover a utility function that will arrange bundles of products in the same manner as those preferences, given a preference ordering? Exists a utility function that adequately captures anlogical preference ordering?A utility function cannot capture every kind of desire.Consider the scenario where someone has intransitive preferences for A B C A. Then u(A), u(B), and u(C) would make up a utility function for these preferences, with u(A) > u(B), u(C), and u(A) being the order of importance. However, it is not feasible.

However, it turns out that we will often be able to discover a utility function to express preferences provided we rule out bizarre circumstances like intransitive preferences. We are aware that a utility function may be used to label the indifference curves, giving greater values to higher indifference curves. How can we go about this?Drawing the diagonal line shown and labelling each indifference curve with its distance from the origin as measured along the line is a simple method.What makes us certain that this is a utility function? It is simple to see that if preferences are monotonic, the line across the origin must precisely meet each indifference curve. All it takes to be a utility function is for each bundle to get a label and for those bundles on higher indifference curves to receive bigger labels.

DISCUSSION

Marginal Utility and MRS

The marginal rate of substitution (MRS), which was may be calculated using a utility function, u(x1, x2). Remember that the MRS calculates the indifference curve's slope for a certain bundle of products, which may be seen as the rate at which a customer is only prepared to exchange a tiny portion of item 2 for good 1.This interpretation provides us with an easy method to determine the MRS. Consider a shift in our consumption of each good, (x1, x2), while maintaining utility, or a shift that advances us along the indifference curve. So, we must haveThe marginal rate of substitution (MRS) may be calculated using the utility function u(x1, x2). Remember that the MRS calculates the indifference curve's slope for a certain bundle of products, which may be seen as the rate at which a customer is only prepared to exchange a tiny portion of item 2 for good 1.This interpretation provides us with an easy method to determine the MRS. Consider a shift in our consumption of each good, (x1, x2), while maintaining utility, or a shift that advances us along the indifference curve. So, we must have The MRS has a negative algebraic sign, meaning that if you obtain more of excellent 1 youmust acquire less of good 2 to maintain the same level of usefulness. Economists often refer to the MRS by its absolute value, i.e., as a positive number, since it becomes quite tiresome to remember to include that annoying negative sign[4]–[6].

As long as it doesn't cause any misunderstanding, we'll stick to this custom.Here is when the MRS calculation becomes interesting: The MRS may be calculated by monitoring a person's real behaviour; we identify the rate of exchange where they are content to remain where they are.The utility function and thus the marginal utility function are not determined exclusively. Any monotonic change of a utility function results in another utility function that is just as useful. Thus, if we, for instance, multiply utility by 2, the marginal utility is also doubled by 2. As a result, the arbitrary selection of the utility function determines the size of the marginal utility function. It relies on the utility function that we employ to characterise behaviour rather than just

behaviour itself.However, the marginal utility ratio provides us with a measureable quantity, namely the marginal rate of replacement. The precise utility function transformation you choose has no effect on the ratio of marginal utilities.n When we take any monotonic modification of a utility function, the same kind of thing happens. The indifference curves are simply renamed when doing a monotonic transformation, and the computation for the MRS discussed above is concerned with travelling along a specific indifference curve. The ratio of marginal utilities is independent of the specific method used to express the preferences, even while the marginal utilities are altered via monotonic transformations.

Utility for Commuting

A bundle of things X must have a greater utility than a bundle of goods Y if X is selected when a bundle of goods Y is offered. Utility functions are essentially approaches to describe decision behaviour. We may estimate a utility function to represent customer behaviour by looking at their selections. This concept has been extensively used in the research of consumer commuting behaviour in the area of transportation economics. In the majority of major cities, commuters may choose between driving or utilising public transport to go to work. Each of these options might be considered to reflect a collection of several qualities, such as travel time, waiting time, out-of-pocket expenses, comfort, and convenience. We may define x1 as the amount of time spent travelling for each mode of transportation, x2 as the amount of time spent waiting for each mode, and so on.

We can consider a model where the consumer chooses to drive or take the bus based on whether he prefers one bundle of characteristics to the other. For example, if (x1, x2,...,xn) represents the values of n different characteristics of driving and (y1, y2,...,yn) represents the values of taking the bus.The marginal utility of each attribute, as expressed by the coefficients on the variables in Equation (4.2), describes the weighted average household's weighting of the different aspects of their commuting trips. The marginal rate of substitution between one characteristic and another is gauged by the ratio of one coefficient to another. For instance, the ratio of the marginal utility of walking time to the marginal value of total time shows that the typical customer views walking time as being nearly three times as onerous as transport time. In other words, if it meant saving one minute of walking time, the customer would be ready to trade it for an extra 3 minutes of journey time.

A similar indicator of how the typical customer trades off these two factors is the cost to travel time ratio. According to this survey, the typical commuter valued each minute of travel time at 0.0411/2.24 = 0.0183 dollars, or $1.10 per hour. In 1967, the study's year, the typical commuter earned roughly $2.85 an hour, as a point of reference. Determining whether or not it is beneficial to make changes to the public transport system may be done using such estimated utility functions. The duration of the journey, for instance, is one of the important elements influencing mode choice in the utility function discussed above. To cut down on this journey time, the municipal transportation authority might, at some expense, introduce additional buses. Will the more riders justify the higher cost, though?

We can predict which customers will drive and which consumers will opt to ride the bus given a utility function and a sample of consumers. This will help us determine if the increased cost will be covered by the income.Additionally, we may calculate each consumer's value of the shortened trip time using the marginal rate of replacement. As we see above, the typical traveller in 1967 valued commuting time at $1.10 per hour according to the Domenich-McFadden survey.

Therefore, the commuter should be prepared to spend roughly $0.37 to shorten their journey by 20 minutes. This figure illustrates the financial gain from offering more punctual bus service. To assess if more punctual bus service is beneficial, this advantage must be weighed against the associated costs. Making an intelligent choice concerning transport policy will undoubtedly benefit from having a quantifiable measure of benefit.

Consumer Demand

The consumer's requested bundle is the best combination of commodities 1 and 2 at a given set of costs and earnings. The consumer's best option will often alter when costs and income fluctuate. The demand function is the function that connects the quantities wanted, or the best option, to the various prices and income levels.The demand functions will be denoted by the notation x1(p1, p2, m) and x2(p1, p2, m) as they rely on both prices and income. There will be a new mix of commodities that the customer will choose as their best option for each unique set of pricing and income. Different preferences will result in various demand functions; examples will be provided soon. In the next chapters, our main focus will be on examining how these demand functions behave and how changes in pricing and income affect consumers' ability to make the best decisions.

Implications of the MRS Condition

In the last part, we looked at the crucial notion that observing demand behaviour might provide significant details about the customer preferences that underlie the behaviour. It is often feasible to estimate the utility function that led to a consumer's decision if there are enough observations of the consumer's choices. However, even if we just see one consumer decision at one set of pricing, we may still draw certain sorts of insightful conclusions about how consumer value will vary as consumption changes. Let's see how this works.It is usual in well-organized marketplaces for everyone to pay nearly the same prices for items. Consider two products like butter and milk as an example.Everyone must have the same marginal rate of substitution for butter and milk if they all have the same pricing for these products, are optimising, and are at an interior solution[7]–[9]. This immediately results from the study shown above. Everybody is changing their consumption of the items until their own "internal" marginal value of the two goods meets the market's "external" valuation of the two goods since the market is providing everyone the same rate of exchange for butter and milk.

The intriguing aspect of this remark is that it is unaffected by money or preferences. People may place quite different values on their overall intake of the two things. Some folks could be eating a lot of butter and very little milk, while others might be eating the opposite. While some affluent individuals may consume a lot of milk and butter, others might just consume a little amount of each. However, the marginal rate of substitution must be the same for each consumer of the two items. one person consuming the products must agree on how much they value one in terms of the other and how much of one they are ready to give up in order to get more of the other.

The ability to evaluate potential changes in consumption bundles is made feasible by the fact that price ratios quantify marginal rates of substitution. Consider the scenario where milk costs $1 per quart and butter costs $2 per pound. If everyone who consumes milk and butter has a marginal rate of substitution of 2, that means they must drink two quarts of milk to make up for one pound of butter. Alternatively, they need 1 pound of butter to make giving up 2 quarts of milk worthwhile. Therefore, a marginal shift in consumption will be valued equally by everyone who

is consuming both items.Imagine that an inventor develops a novel method of converting milk into butter that produces only 1 pound of butter from every 3 quarts of milk it is fed, with no other usable byproducts. Is there a market for this technology? The answer is that the venture investors won't rush to his door. Why would people be willing to trade 3 quarts of milk for 1 pound of butter when everyone is currently functioning at a place where they are only willing to deal 2 quarts of milk for 1 pound of butter? The answer is no, since this innovation is worthless[10].

However, what would happen if he managed to make it to operate in reverse so that he could add a pound of butter and remove three quarts of milk? Is there a demand for this product? In affirmative, We may infer from the market pricing for milk and butter that consumers are only barely willing to exchange one pound of butter for two quarts of milk. Because of this, receiving 3 quarts of milk for a pound of butter is a better value than what is now available. Please register me for 1,000 shares. The first machine is not lucrative, as seen by the market pricing, since it makes $2 of butter from $3 of milk. Its unprofitability is merely another indicator that consumers place a higher value on inputs than they do on products.

The second machine uses just $2 worth of butter to make $3 worth of milk. People value the outputs of this machine more than the inputs, which is why it is lucrative.The idea is that because prices reflect how readily consumers are prepared to switch from one commodity to another, they can be used to assess the merits of policy ideas that call for altering consumption patterns. One of the most basic and crucial concepts in economics is the notion that prices are not random amounts of money but rather a reflection of how people value goods on a marginal basis.The MRS is obtained at one consumption point if we witness one option at one set of costs. We get a new MRS if the costs change and we see another option. As we make more and more choices, we have a better understanding of the characteristics of the underlying preferences that may have led to the decision behaviours that is being seen.

CONCLUSION

the notion of utility determination is crucial in economics and helps to explain how consumers behave and how decisions are made. Stakeholders may acquire insight into customer preferences, forecast market demand, and make wise choices by knowing total utility, marginal utility, and the variables impacting utility determination. Utility is a useful metric for assessing customer happiness and maximising market resource allocation.Understanding consumer preferences and decision-making processes depends on how utility is determined. This study's objective was to examine the variables that affect utility and how they may affect consumer choices and market outcomes.According to the survey, utility is a measure of how happy or satisfied people are with theirpurchases of products and services. There are several theories and methods for measuring utility, such as ordinal utility, which ranks preferences without giving precise numbers, and cardinal utility, which gives utility numerical values.This research offers insights into utility determination and its consequences for consumer behaviour and market outcomes via rical analysis, experimental investigations, and theoretical frameworks.

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CHAPTER 5

ANALYSIS OF DEMAND ANALYSIS IN MODERN ECONOMICS

Dr. Dasinis Nathan Annette Christinal
Assistant Professor,Masters in Business Administration (E-Commerce),
Presidency University, Bangalore, India.
Email Id: annette.c@presidencyuniversity.in

ABSTRACT:

Demand analysis in contemporary economics focuses on the fundamental ideas, procedures, and elements that affect consumer demand for products and services. The research looks at how demand is determined, how elasticity is measured, and how demand analysis is used in different economic circumstances. To make educated judgements, forecast market behaviour, and create successful strategies, firms, governments, and academics must have a solid understanding of demand analysis.This research project examines the role of demand analysis in contemporary economics and looks at the variables affecting market dynamics and consumer behaviour. A key concept in economics is demand analysis, which looks at the connection between the cost of an item or service and the volume of demand. The law of demand, price elasticity, income elasticity, and cross-price elasticity are among the ideas and frameworks covered in the subject. It looks at how market results are impacted by demand drivers such consumer preferences, income levels, the cost of linked commodities, and demographic characteristics.

KEYWORDS:

Consumer Demand, Demand Analysis, Determinants, Elasticity, Market Behavior, Strategies.

INTRODUCTION

Normal and Inferior Goods

As a consumer's income varies, so does his demand for a product. We are interested in how the best option at one income level compares to the best option at a different level of income. In this experiment, we'll keep the prices constant and focus exclusively on the shift in demand brought on by the change in income. When prices are constant, we know how an increase in monetary income impacts the budget line: it parallel moves the budget line outward. How does this impact demand, it makes sense to assume that as income rises, so does demand for each product. With a remarkable lack of creativity, economists refer to these products as typical goods. If good 1 is a typical good, demand for it will rise with rising income and fall with falling income. For a typical product, demand constantly fluctuates in the same manner as income does, when something is described as normal, you can be sure that there is a chance that it might also be aberrant. And there is, in fact. An example of a pleasant, well-behaved indifference curve where a rise in income causes a decrease in the consumption of one of the commodities. An inferior good is anything like that. Though it may seem "abnormal," substandard products are really rather common. Demand for many products falls as money rises; examples include gruel, bologna, shacks, or just about any form of subpar product[1]–[3].Depending on the income level under consideration, we may determine if a thing is inferior or not. It's very possible that when their wealth rises, folks who are really impoverished eat more bologna. However, if wealth

continued to rise, the consumption of bologna would undoubtedly start to drop after a while. It is pleasant to know that economic theory allows for both possibilities since in reality, consumption of commodities might rise or fall as income rises.

Income Offer Curves and Engel Curves

An rise in revenue results in a parallel movement of the budget line outward. As we move the budget line outward, we may link the requested bundles we get to create the income offer curve. This curve demonstrates the sets of products that are desired at various income levels, The income growth route is another name for the income offer curve. The income growth route will have a positive slope if both items are normal goods. There will be some ideal option for each of the commodities for each amount of income, m. Let's concentrate on excellent 1 and think about x1(p1, p2, m), which is the best option given each combination of prices and income. Simply put, this is excellent 1's demand function. The Engel curve results from holding the prices of items 1 and 2 constant while observing how demand varies as income changes. The Engel curve is a graph that shows, with all prices kept constant, the demand for one of the items as a function of income. An example of an Engel curve is

The Engel curves and income offer curves that we have seen thus far have all been simple in fact, they have all been straight lines! This has occurred as a result of how basic our examples have been. Straight lines are not necessary for real Engel curves. Generally speaking, as income rises, the demand for an item may rise more or less quickly than income. When demand for an item increases more than income, we refer to it as a luxury good; when demand increases less than income, we refer to it as a necessity good.

Assume that the ratio of good 1 to good 2 is the sole factor that influences the consumer's choices. Because the ratio of good 1 to good 2 is the identical for all of these bundles, if the customer likes (x1, x2) to (y1, y2), she will also prefer (2x1, 2x2) to (2y1, 2y2), (3x1, 3x2) to (3y1, 3y2), and so on. For every positive value of t, the consumer really prefers (tx1, tx2) over (ty1, ty2). These inclinations are referred to as homothetic preferences. The three types of preferences mentioned above perfect replacements, perfect complements, and Cobb-Douglas can all be easily shown to be homothetic preferences.

Quasilinear Preferences

The situation of quasilinear preferences is another kind of choice that produces a unique type of income offer curves and Engel curves. Remember how quasilinear preferences are defined. Here, all difference curves are "shifted" variations of the same difference curve. The utility function for these preferences is equivalently expressed as u(x1, x2) = v(x1)+x2. If we move the budget line outside, what happens? If an indifference curve in this situation is tangent to the budget line at a bundle (x 1, x 2), then another indifference curve must likewise be tangent at (x 1, x 2+k) for any constant k. Gaining more money has no impact on the demand for good 1, and all of it is spent exclusively on purchasing good 2. A "zero income effect" for good 1 is frequently referred to if preferences are quasilinear. As a result, good 1's Engel curve is a vertical line; regardless of changes in income, good 1's demand does not vary.

Substitutes and Complements

the words complements and replacements, but it is now necessary to provide a precise definition. It appears appropriate to consider the imperfect situation because we have previously seen

several instances of perfect alternatives and complements.Let's start by considering alternatives. We claimed that, at least for someone who didn't care about colour, red and blue pencils may be seen as ideal alternatives. What about pens and pencils, though? This is an instance of "imperfect" replacements. In other words, pens and pencils may be used in place of each other to some extent, however they aren't a perfect match as red and blue pencils are.

In a similar vein, we declared that the right and left shoes made the ideal pair. What about a pair of shoes and some socks, though? Socks and shoes are often eaten together, as are the right and left shoes almost always. Shoes and socks are examples of complementary items that, while not always, tend to be consumed together. After talking about the fundamental concept of complements and replacements, we may provide a detailed economic formulation.

Remember that the price of both good 1 and good 2 will normally affect the demand function for good 1, therefore we write x1(p1, p2, m). We may inquire as to whether the demand for good 1 increases or decreases when the price of good 2 changes. When the demand for good 1 increases in response to an increase in the price of good 2, we may argue that good 1 is a replacement for good 2. Good 1 replaces Good 2 in terms of rates of change if According to the theory, as good 2 becomes more costly, the customer changes to buying good 1, or avoids the more expensive commodity altogether.

On the other side, we argue that good 1 is a complement to good 2 if demand for good 1 declines as the price of good 2 rises. This indicates that x1 p2 0. When the price of a complement rises, the consumption of the other complement will often fall since complements are items that are eaten together, such as sugar and coffee. These ideas are effectively illustrated by the situations of perfect complements and replacements. It should be noted that x1/p2 is positive (or zero) for perfect replacements and negative for perfect complements[4]–[6].There should be a few cautions issued about these ideas.

First, when it comes to complements and replacements, the twogood example is quite unique. Given that revenue is being maintained constant, increasing the cost of good 1 will result in decreasing the cost of good in the future. The types of behaviour that are permitted are rather constrained as a result. These limitations are less of an issue when there are more than two items.

Second, even if the definitions of complements and replacements in terms of consumer demand behaviour appear reasonable, there are some issues with them in more general situations. For instance, if we apply the aforementioned criteria to a scenario involving more than two goods, good may be a suitable replacement for good 3, while good 3 may be a suitable complement to good.

More sophisticated treatments often employ a somewhat different definition of complements and replacements due to this particular property. The terms gross complements and gross substitutes are defined in the aforementioned definitions; they are enough for our purposes.

DISCUSSION

The Inverse Demand Function

The demand curve may be obtained by plotting p1 versus x1 while holding p2 and m fixed. As previously said, we often believe that the demand curve slopes downward, meaning that lower demand results from higher prices, but the Giffen example demonstrates that this isn't always the

case. It makes sense to refer to the inverse demand function as long as the demand curve is, as is typical, downward-sloping. The demand function that views price as a function of quantity is known as the inverse demand function. In other words, the inverse demand function calculates the price at which good 1 would have to be sold in order for a consumer to pick a certain level of consumption for each degree of demand for good 1. In other words, the inverse demand function measures the same connection as the direct demand function, only from a different angle.

For the sake of simplicity, assume that the cost of good 2 is one. The price of good 1 then represents how much the customer is ready to give up of good 2 in order to acquire a bit more of good 1, according to equation (6.4), at the optimum level of demand. In this instance, the MRS's absolute value is only being measured by the inverse demand function. The inverse demand function reveals, for any ideal level of x1, how much of good 2 the customer would like to have to make up for a modest decline in the supply of good 1. Alternately, the inverse demand function calculates the amount of good 2 the consumer would be prepared to give up in order to become just as unconcerned about having a bit better 1. The MRS is the amount of money a person would be prepared to give up in order to have a little bit more of good 1 if we consider good 2 to be money to spend on other goods. The MRS may be seen in this context as assessing the marginal willingness to pay, as we previously stated. Since the cost of item 1 in this instance is just the MRS, the cost of good 1 alone serves as a gauge for the marginal willingness to pay.

The inverse demand function calculates how much the consumer is prepared to forego for a little amount more of good 1, or, put another way, how much the customer was willing to forego for the previous unit of good 1, for each quantity x1. They are equivalent for a small enough quantity of excellent. This new perspective gives the downward-sloping demand curve fresh significance. When x1 is extremely tiny, the customer is prepared to part up a large quantity of money, or a sizable number of other items, in order to get a modest increase in good 1. The customer is prepared to part with less money, on the margin, to get a little bit more of good 1 as x1 increases. Therefore, as we raise the consumption of good, the marginal willingness to payor the marginal readiness to give up good decreases.

From Revealed Preference to Preference

The aforementioned section may be succinctly summarised. The choices individuals make **are** better than the options they might have made, according to our model of consumer behaviour, which assumes that people buy the finest items they can afford. In other words, if (x1, x2) is explicitly shown to be preferred to (y1, y2), then (x1, x2) is in fact preferred to (y1, y2). Let's put this idea in formal terms:The Revealed Preference Principle. When prices are (p1, p2), let (x1, x2) be the selected bundle. Let (y1, y2) be another bundle such that p1x1 + p2x2 p1y1 + p2y2. We therefore need (x1, x2) (y1, y2) if the customer is selecting the most desired bundle that she can afford.This idea can appear counterintuitive when you first hear it. Doesn't it follow that X is preferred to Y if X is shown to be preferred to Y? No, is the response. "Preference" denotes the consumer's ranking of X higher than Y, whereas "revealed preferred" simply indicates that X was picked when Y was more cheap. If the customer selects the best bundles she can afford, "revealed preference" implies "preference," but this is a result of the behaviour model rather than a definition of the words.This is why, as was previously mentioned, it would be preferable to indicate that one bundle is "chosen over" another. The concept of revealed preference would thus be stated as follows: "If a bundle X is chosen over a bundle Y, then X must be preferred to Y." In

this assertion, it is made obvious how the behaviour model enables us to utilise observed decisions to draw conclusions about underlying desires.

Regardless of the nomenclature, the main idea is unmistakable: if we see that one bundle is picked while another is more inexpensive, then we have discovered something about the preferences between the two bundles, namely that the first is preferred to the second.Now imagine that we already know that bundle (y1, y2) is in demand at price (q1, q2) and that bundle (y1, y2) itself has been shown to be preferable over another bundle (z1, z2).

Recovering Preferences

We can discover the preferences of the customer by looking at the decisions they make. We can obtain a better and better idea of the consumer's preferences as we witness more and more options. Making judgements on policies may benefit greatly from such preference information. Most economic policies entail exchanging some items for others. For example, if we tax shoes and subsidise clothing, we'll likely have more clothing and less shoes in the end. It's critical to have some understanding of customer preferences for apparel and footwear in order to assess the merits of such a programme. We may get this data by looking at customer decisions and using revealed preference and associated strategies[7]–[9].

We can get more accurate estimations regarding the shape of indifference curves if we're prepared to make additional customer preference assumptions.Assume, for instance, that we see two bundles Y and Z that are willingly willing to postulate preferences are convex and that they are disclosed preferable to X, Then, we understand that all weighted averages of Y and Z are also preferable to X. All bundles that include more of both commodities than X, Y, and Z—or any of their weighted averages—are likewise preferred to X if preferences are assumed to be monotonic.

The Weak Axiom of Revealed Preference

All of the aforementioned is predicated on the notion that consumers have preferences and always choose the finest combination of items they can afford. The "estimates" of the indifference curves that we created above are meaningless if the customer is not acting in this manner. Naturally, the issue of how to determine if the customer is using the maximising model emerges.Alternately, what type of evidence would persuade us that the customer was not maximising Could a buyer who maximises their purchase make both of these us to draw two conclusions in accordance with the logic of revealed preference: (1) (x1, x2) is preferred to (y1, y2); and (2) (y1, y2) is preferred to (x1, x2).Clearly, this is ludicrous. the customer seems to have selected (x1, x2) when she had the option of selecting (y1, y2), showing that (x1, x2) was preferable to (y1, y2). However, she later selected (y1, y2) when she had the option of selecting (x1, x2), indicating the reverseIt is obvious that this customer cannot be a maximising customer. Either the customer isn't selecting the best package she can afford, or the choice issue has altered in some other way that we haven't seen. Perhaps the consumer's preferences or another element of her financial situation have altered. In any case, a breach of this kind contradicts the theory of consumer choice in a constant environment[10].According to the theory of consumer choice, such observations won't take place. If customers are selecting the finest products they can afford, then products that are inexpensive but aren't picked must be inferior to those that are. This straightforward idea was put out by economists in the following fundamental axiom of consumer theory.

CONCLUSION

Modern economics relies heavily on demand research because it offers insights into consumer behaviour, market dynamics, and the variables affecting the amount of products and services required. Businesses, governments, and academics may make wise judgements and create successful strategies by understanding demand analysis.The amount of products and services that customers are willing and able to buy is substantially influenced by the demand drivers, which include consumer preferences, income levels, product pricing, population demographics, and consumer expectations. It is possible to better understand consumer behaviours and the variables influencing demand changes by analysing these determinants.Demand analysis is essential for anticipating the market, determining price plans, and formulating policy. Businesses can forecast market trends, improve pricing tactics, and create successful marketing campaigns by understanding customer demand and underlying factors. Demand analysis may be used by policymakers to create policies that support consumer welfare, market competitiveness, and financial stability.\ Demand analysis in contemporary economics is better understood with the use of empirical research, econometric modelling, and case studies. Researchers can determine customer preferences, quantify the effects of pricing changes, and evaluate market dynamics by applying rigorous analysis to real-world data.

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CHAPTER 6

ANALYSIS OF THE SUBSTITUTION EFFECT: UNDERSTANDING CONSUMER BEHAVIOR AND MARKET DYNAMICS

Dr. Mounica Vallabhaneni
Assistant Professor, Department of Commerce and Economics,
Presidency University, Bangalore, India.
Email Id: mounicav@presidencyuniversity.in

ABSTRACT:

The study of the economic substitution impact. The substitution effect is the shift in consumption habits that takes place when the relative costs of products and services vary but utility levels remain constant. The substitution effect idea, its effects on consumer behaviours, and its importance in comprehending market dynamics are all examined in the research. For governments, corporations, and academics to forecast consumer reactions to price changes and make wise judgements, they must have a thorough understanding of the substitution impact.The substitution effect in economics will be explored in this paper, along with its effects on consumer behaviours and market dynamics. The underlying idea of the substitution effect looks at how changes in relative pricing affect consumers' decisions between products and services. The research goes into the theories and frameworks, such as the maximization of consumer value and the idea of price elasticity of demand, that are used to analyze the substitution impact. It looks at how factors like price changes, income levels, and consumer preferences affect consumption patterns and how these affect the replacement effect. The study also examines how the substitution impact affects resource allocation, market equilibrium, and policy-making. This research offers insights into the substitution impact and supports evidence-based decision-making in many economic sectors via empirical analysis, econometric modelling, and case studies.

KEYWORDS:

Consumer Behavior, Consumption Patterns, Economics, Market Dynamics, Price Changes, Substitution Effect.

INTRODUCTION

There are two different types of consequences when an item's price changes: one is a change in the rate at which you can exchange one good for another, and the other is a change in the overall buying power of your income. For instance, if good 1 gets more affordable, you'll need to forego less of good 2 to buy good 1. The market's willingness to let you "substitute" good 2 for good 1 has changed in response to the change in the price of good 1. The customer is now presented with a different trade-off between the two commodities by the market.Additionally, if good 1 gets less expensive, your income will allow you to purchase more of it. Even if you have the same amount of money, more may now be purchased with it thanks to an increase in buying power.

The substitution impact refers to the first component, which is the shift in demand brought on by the change in the exchange rate between the two items. The income impact is the second effect,

which is the shift in demand brought on by having greater buying power. These are only a few outlines of the two impacts. We must think about the two impacts in further depth in order to provide a more exact description.To do this, we will divide the price movement into two phases: first, we will allow relative prices to fluctuate while adjusting money income to maintain buying power, and second, we will allow purchasing power to vary while maintaining comparable prices at the same level.Referring will help explain this the best. In the current instance, the cost of good 1 has decreased. The budget line therefore spins around the vertical intercept m/p2 and flattens out. This budget line shift may be divided into two steps: The budget line should first be rotated around the first required bundle, and then it should be moved out to the new wanted bundle[1]–[3].

We have an easy approach to divide the change in demand into two halves thanks to this "pivot-shift" process. The first stage, known as the pivot, involves a change in the budget line's slope while keeping its buying power constant, while the second step involves a change in the slope while changing the purchasing power. The customer only notices a change in price and selects a different bundle of items in response; this decomposition is merely a hypothetical construction. However, it is helpful to conceive of the budget line shifting in two stages first the pivot, then the shiftwhen examining how the consumer's preference changes. What do the changed and pivotal budget lines signify economically? Let's start by thinking about the pivoted line. Here, we have a budget line that has the same slope as the final budget line and, as a result, the same relative pricing.However, because of the varied vertical intercept, the financial revenue related to this budget line is different. The initial consumption bundle (x1, x2) is merely affordable since it is on the redirected budget line. The consumer's buying power has not changed since the original package of products is still justifiably affordable at the current pivoted queue.

Sign of the Substitution Effect

Whether a good is a typical good or a subpar good determines whether the revenue impact will be favourable or negative. What about the impact of substitution? When a good's price decreases, as, the substitution impact must result in a nonnegative change in the good's demand. In other words, if p1 > p 1, then we must have x1(p 1, m) x1(p1, m), resulting in xs 1 0.The following provides evidence for this. Think about the locations along the pivoted budget line where less of good 1 is utilised than at bundle X. All of these packages were reasonably priced at the previous pricing (p1, p2), but none were bought. In its place, the bundle X was bought.If the client always selects the best bundle he can afford, then X must be chosen above all other bundles on the portion of the pivoted line that is located within the initial budget determined.

This implies that the bundle that is under the original budget line cannot be the best option on the flipped budget line. Either X or a point to the right of X would be the best option on the pivoted line. However, this implies that, as we wished to demonstrate, the new optimum option must include eating at least equal amounts of good 1 as before. He substitution impact moves in direct opposition to price movement at all times.Since the replacement impact's change in demand opposes the change in price, we argue that the substitution effect is negative: Due to the substitution effect, the demand for the product declines as the price rises.

The Law of Demand

There were also reservations about the consumer theory's seeming lack of specificity: demand may grow or decrease in response to changes in price and income.A theory isn't much of a theory

if it doesn't limit observable behaviour in some way. A paradigm with universal consistency has no substantive substance.The Strong Axiom of Revealed Preference, which states that decisions made by an optimising consumer must satisfy it, is evidence that consumer theory does have some substance. Additionally, we've seen that every price change can be broken down into two separate changes: an income impact, whose sign depends on whether the product is a normal good or an inferior item, and a substitution effect, which is certain to be negative and opposite the price change's direction. nConsumer theory does not limit how demand varies in response to changes in price or income, but it does limit how these two types of changes interact. For example, we have the followingthe Demand Law. If a good has a positive relationship between demand and income, then demand for that commodity must fall as price rises.From the Slutsky equation, it is clear that if demand rises as income rises, we have a normal good. Additionally, if the commodity in question is a standard good, both the income impact and the substitution effect will unquestionably lower demand as the price rises.

DISCUSSION

Another Substitution Effect

The shift in demand that occurs when prices change but a consumer's buying power is maintained, keeping the original bundle affordable, is known to economists as the substitution effect. This, at least, is one way to define the replacement effect. Another definition exists, and it is equally helpful.The Slutsky replacement effect is defined as in the aforementioned section. The Hicks substitution effect is the name of the term we shall discuss in this section.Consider rolling the budget line around the indifference curve through the original consumption bundle rather than pivoting it around the original consumption bundle. This would allow us to present the consumer with a new budget line that has the same relative prices as the final budget line but a different income. He will no longer be able to afford the items under this budget line with his current buying power. In this way, the Hicks substitution effect maintains utility rather than buying power. The Hicks substitution effect offers the customer just enough money to return to his former indifference curve, but the Slutsky substitution effect just gives the consumer enough money to return to his previous level of spending. Despite this definitional discrepancy, it turns out that the Hicks replacement effect, like the Slutsky substitution effect, must be negative that is, it must be in the opposite direction from the price change.

Again, disclosed preference serves as the evidence. Let (x1, x2) be a bundle that is demanded at certain prices (p1, p2) and (y1, y2) be a bundle that is demanded at certain prices (q1, q2). If the consumer cannot be made to choose between (x1, x2) and (y1, y2) due to the customer's indifference, neither bundle can be shown to be preferable to the other.This equation states that, as we wished to demonstrate, the change in the amount required must have the opposite sign of the change in price[4]–[6].Although it is now the Hicks substitution effect, the overall change in demand is still equal to the substitution effect plus the income impact. The Slutsky equation has the exact same form as the one we had previously and the same meaning since the Hicks substitution effect is likewise negative.Which definition of the replacement effect is more relevant depends on the specific issue at hand. Both the Slutsky and Hicks formulations have their place. It can be shown that the two replacement effects are almost equal for tiny price changes.

Compensated Demand Curves

Holding income constant (the usual case), holding buying power fixed (the Slutsky substitution effect), and keeping utility fixed (the Hicks substitution effect), the quantity required varies when a price changes in each of these three scenarios. As long as we maintain any one of these three factors constant, we may establish a correlation between price and amount desired. The standard demand curve, the Slutsky demand curve, and the Hicks demand curve are the three distinct demand curves that result from this.The Slutsky and Hicks demand curves are invariably downward sloping curves, according to the study of this chapter. Additionally, the demand curve for typical items has a declining slope. The Giffen study, however, demonstrates that it is theoretically conceivable for the normal demand curve to slope higher for a subpar commodity.

The compensated demand curve is another name for the Hicksian demand curve, which is the one where utility is constant. If you consider creating the Hicksian demand curve by changing income when the price changes to maintain the consumer's utility constant, this phrase becomes obvious. Since his utility is constant over the Hicksian demand curve, the customer gets "compensated" for price variations. This is not the case when there is a typical demand curve. Since his income is stable in this situation, the customer is worse off paying higher prices than lower ones.It turns out that the compensated demand curve is highly helpful in advanced courses, particularly when discussing benefit-cost analysis. In this kind of study, it seems sense to inquire about the amount of payments required to make up for lost revenue due to a change in policy. The size of these payments provides an accurate assessment of the price of the policy change.

Buying And Selling

The income of the customer was provided in the consumer model that we looked at in the chapters before. In actuality, individuals make their living by selling the things they possess, most often their own labour but sometimes stuff they have created or gathered.

Net and Gross Demands

the two-good model for now. Now, we'll assume that the customer has an initial endowment of the two products, which we'll represent by (1, 2).1 Before entering the market, the customer possesses this quantity of each commodity. Imagine a farmer who carries one unit of carrots and two units of potatoes to the market. The farmer examines the market pricing before deciding how much of each product he wants to purchase and sell.Let's distinguish between the consumer's gross needs and his net demands in this instance. The quantity of an item that a customer really consumes, or how much of each good they actually wind up bringing home from the market, is known as the gross demand. The difference between what the customer actually purchases (the gross demand) and the initial stock of goods is the good's net demand. The volume of purchases or sales of an item constitutes its net demand.

If (x1, x2) are considered to represent the gross needs, then the net demands are (x1 1, x2 2). It should be noted that although the net demands may be positive or negative, the gross demands are normally positive amounts. If the net demand for good 1 is negative, it indicates that the consumer wants to provide good 1 to the market rather than consume more of it than she already possesses.An quantity provided is only a negative net demand.Since the customer is ultimately concerned with them, the gross needs are more significant for economic analysis. However, net

requests are more in line with what the general public understands by demand or supply since they reflect what is really shown in the market.

Changing the Endowment

analysis of preference We looked at how, with stable prices, the optimum consumption varied when the money income changed.Here, we may do a similar analysis by examining how, with constant prices, the optimum consumption varies as the endowment changes.Consider the case when the endowment changes from (1, 2) to another value (1, 2), as shown in Due to this disparity, the new endowment (i.e., 1, 2) is less valuable than the previous endowment, resulting in a lower income that the consumer may get by selling her endowment.shows this graphically: the budget line moves inward. We can draw the same two conclusions from this as we did from our analysis of the previous scenario as this is precisely the same as a decrease in monetary income. First off, since her options for consuming have been limited, the consumer is unquestionably in worse shape with the endowment (see numbers 1, 2) than she was with the previous endowment. Second, her desire for each product will vary depending on whether it is a superior or a standard item.

For instance, if good 1 is a typical product and the customer's endowment changes in a manner that lowers the value of good 1, we may infer that the consumer will have less of a need for good 1.the scenario in which the endowment's value grows. Based on the aforementioned justification, we get to the conclusion that the customer must benefit if the budget line goes outward in a parallel manner. According to algebra, if the endowment switches from (1, 2) to (1, 2) and p1 + p2 = p1 + p2, the consumer's new budget set must also include her previous budget set. This indicates that the consumer's best option given the new budget must be chosen above the consumer's best option given the previous endowment[7]–[9].The customer sells good 1 at first and continues to do so even after the price has dropped. What can we say about the wellbeing of this customer? Will this be the case in most cases? In the scenario shown, the customer is on a lower indifference curve after the price modification than before. Applying the revealed choice principle yields the solution.

The consumer's new consumption bundle must be on the coloured portion of the new budget line if she continues to be a provider. However, this portion of the new budget line falls inside the former budget set since the customer had access to all of these options prior to the price adjustment. All of these options are thus poorer than the initial consumption bundle according to revealed preference. There is no way to know whether the customer will do better or worse in this situation.if a consumer is a net buyer of an item, its price rises, and the consumer ideally chooses to continue buying the good, then she must unquestionably be in greater financial straits. However, if the price rise prompts her to start selling, things might either become better or worse for her. Similar to the situations mentioned above, these findings result from a straightforward application of revealed preference, but it is still a good idea for you to sketch a graph to make sure you understand how this works.We may also draw some intriguing conclusions from revealed preference on the choice of whether to continue being a buyer or switch to a seller when prices change[10].

CONCLUSION

The study of the substitution effect offers insightful information about consumer behaviour and how it affects market dynamics. Stakeholders may make educated choices, forecast market

reactions, and create strategies that are in line with consumer preferences by studying how consumers modify their consumption habits in response to price changes. A key idea in economics, the substitution effect offers a framework for comprehending the intricate relationships between pricing, consumer behaviour, and market results.A key idea in economics that affects consumer behaviour and market dynamics is the substitution effect. This study's objective was to examine the substitution effect's effects on consumer decisions and market outcomes.The substitution effect, which was discovered via the research, looks at how changes in relative pricing affect consumers' decisions between products and services. In order to maximise their utility or happiness, consumers modify their consumption habits when the relative price of one commodity varies in comparison to another.

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CHAPTER 7

ANALYSIS OF INTERTEMPORAL CHOICE: UNDERSTANDING DECISION-MAKING OVER TIME

Mr. Yelahanka Lokesh
Assistant Professor, Department of Commerce and Economics,
Presidency University, Bangalore, India.
Email Id: lokesh.yr@presidencyuniversity.in

ABSTRACT:

The decision-making process that involves balancing current and future consumption or investment possibilities is referred to as an intertemporal choice. The ideas of time preference, discounting, and variables affecting intertemporal decision-making are all explored in the research. In order to make choices that maximise This study tries to analyse the idea of intertemporal choice and look into the variables that affect how people make decisions throughout time. The decision-making process when people consider the advantages and disadvantages of actions or events that take place at various times in time is referred to as intertemporal choice. The analysis of intertemporal choice is done using a variety of theories and models, including as discounting, time preferences, and hyperbolic discounting. It investigates the psychological and economic variables, such as future value perception, time horizon, uncertainty, and self-control, that affect intertemporal decision-making. The study also looks at the effects of intertemporal choice in a range of settings, such as personal finance, saving habits, investment choices, and policy-making. This research offers insights into intertemporal choice and supports evidence-based decision-making in domains relating to long-term planning, goal-setting, and resource allocation via empirical analysis, experimental investigations, and theoretical frameworks.

KEYWORDS:

Decision-Making, Discounting, Economics, Intertemporal Choice, Long-Term, Present, Time Preference.

INTRODUCTION

The Themes of Microeconomics

The restricted incomes that consumers may spend on products and services, the constrained financial resources and technological capacity available to businesses, and the constrained amount of hours per week that employees can devote to work or pleasure are all central themes in microeconomics. Microeconomics, however, is also about how to maximise these constraints. More specifically, it has to do with how limited resources are distributed. Microeconomics, for instance, discusses how customers might most effectively distribute their limited money among the numerous items and services offered for purchase. It shows how employees might most effectively divide their time between work and pleasure, or between one job and another. Additionally, it describes how businesses may effectively use their limited financial resources between manufacturing one line of goods vs another and recruiting more people versus purchasing new equipment.

These choices on resource allocation are mostly determined by the government in a planned economy like that of Cuba, North Korea, or the former Soviet Union. Workers have little choice in their employment, hours worked, or even where they reside, and customers often have a very little selection of items to pick from. Firms are instructed what to create, how much to produce, and how to make it. As a consequence, many of the microeconomics' methods and ideas have little application in such nations[1]–[3].

Trade-Offs

When it comes to distributing limited resources, customers, employees, and businesses have far more freedom and choice in contemporary market economies.Microeconomics explains the trade-offs that customers, employees, and businesses must make and demonstrates how these trade-offs should be made.The limited funds available to consumers might be used to purchase a broad range of products and services or saved for the future. Chapters 3, 4, and 5 of this book are devoted to the topic of consumer theory, which explains how consumers, depending on their preferences, maximise their well-being by balancing the purchase of more of certain commodities with the purchase of less of others. Additionally, we'll see how customers choose how much of their wages to save, sacrificing the now for the future.

WORKERS Additionally, there are limitations that employees must deal with. Prior to doing so, individuals must choose whether and when to join the labour. One must choose between working now and earning an immediate income and continuing their education in the hopes of earning a greater income in the future since the types of jobs—and related pay scales—that are accessible to a worker rely in part on educational attainment and acquired abilities. Second, while choosing a job, people must make trade-offs. For instance, some individuals choose to work for giant corporations, which provide job security but have few opportunities for promotion, while others prefer to work for small businesses, which have more advancement opportunities but less job security. Finally, employees sometimes have to make a decision on the number of hours they intend to put in each week, balancing work with leisure.

FIRMS The types of things that businesses can manufacture and the resources available to do so are likewise constrained. For instance, General Motors excels in manufacturing cars and trucks but struggles to manufacture computers, aeroplanes, or pharmaceuticals. Its financial resources and the existing manufacturing capability of its plants are likewise limited.GM must choose how many of each kind of car to make in light of these limitations. It must choose between adding more employees, constructing additional plants, or doing both if it wants to produce a greater overall volume of cars and trucks the next year or the year after.

Prices and Markets

The function of pricing is a second key topic in microeconomics. All of the aforementioned trade-offs are predicated on the costs that customers, employees, or businesses must pay. For instance, a buyer may choose to substitute chicken for beef based on both price and personal taste. The "price" that employees may get for their labour, i.e. the salary, influences how they choose to trade off their job for leisure. Additionally, labour rates and machine costs have a role in how businesses decide whether to increase their workforce or buy additional machines.

Pricing is another topic covered in microeconomics. In a system where prices are centrally managed, the government controls them. In a market economy, interactions between customers,

employees, and businesses decide pricing. These exchanges take place in markets, which are gatherings of buyers and sellers who jointly decide on a product's price. For instance, rivalry between Ford, General Motors, Toyota, and other manufacturers, as well as customer needs, have an impact on vehicle costs in the automotive industry. The third significant element in microeconomics is the key significance of markets.

Theories and Models

Economics is concerned with the explanations of observable events, much like any other science. Why, for instance, do businesses often recruit new employees or fire existing ones when the cost of their raw materials changes? How many employees are expected to be employed or fired by a company or industry if raw material prices rise by, say, 10%?Similar to other disciplines, economics relies on theories to explain phenomena and make predictions. Theories are created to interpret observable occurrences in terms of a predetermined set of fundamental precepts and premises. For instance, the theory of the company starts with the straightforward assumption that businesses aim to maximise profits. This presumption is used by the theory to explain how businesses decide how much labour, capital, and raw materials to employ in their manufacturing processes as well as how much output to create.It also discusses how the pricing of inputs like labour, capital, and raw materials, as well as the prices that businesses may get for their products, affect these decisions.Making forecasts is also based on economic theory. So, based on the theory of the business, we can determine whether a company's production level would rise or fall in response to changes in pay rates or raw material prices. Theories may be used to build models from which quantitative predictions can be produced by using statistical and econometric approaches.

DISCUSSION

Positive versus Normative Analysis

Positive and normative issues are equally important to microeconomics. Normative inquiries focus on what should be, whereas positive questions deal with explanation and prediction. Imagine that a foreign automobile import quota is imposed by the American government. What will happen to the cost, volume, and sales of automobiles? What effect would the shift in policy have on American consumers? relating to auto industry workers? These inquiries fall within the category of positive analysis, which includes explanations of causal links.

Microeconomics is based on positive analysis. As we said above, theories are created to explain phenomena, then they are put to the test against observations in order to create models that can then be used to make predictions. Both business managers and public policy makers must utilise economic theory to make predictions. Let's say the federal government is thinking of increasing the petrol tax. The adjustment would have an impact on the cost of petrol, customer decisions about small or big automobiles, the volume of driving, and other factors. Oil companies, automakers, makers of vehicle components, and businesses in the tourism sector would all need to anticipate the effect of the shift in order to prepare wisely. The consequences would also need to be quantified for government officials. They would want to know how much it would cost consumers (perhaps split down by income brackets), how it would affect the oil, car, and tourism sectors' earnings and jobs, and how much tax money would likely be raised annually[4]–[6].

Sometimes we wish to pose questions like "What is best?" that go beyond explanation and prediction. This entails normative analysis, which is crucial for both business managers and those responsible for creating public policy. Consider a new petrol tax once again. Once the levy is in place, automakers will want to decide what proportion of big and small vehicles to create in order to maximise profits. How much money specifically has to be put into making automobiles more fuel-efficient? Whether the tax is in the public interest is likely to be the main concern for policymakers. A other kind of tax, such as a tariff on imported oil, may be able to more effectively achieve the same policy goals (such as an increase in tax revenues and a reduction in reliance on imported oil..

Normative analysis takes into account the design of specific policy alternatives in addition to alternative policy options. Let's say, for instance, that it has been agreed that a tax on petrol is desirable. We then inquire as to the ideal tax rate after weighing the advantages and disadvantages.Value judgements are often used to augment normative analysis. For instance, a comparison of an oil import tariff and a petrol tax may show that the latter is simpler to implement but will have a bigger effect on people with lower incomes. At that juncture, society must balance equality and economic efficiency in a value decision. The optimum course of action cannot be determined by microeconomics when value judgements are involved. However, it may serve to make the trade-offs clearer, illuminating the concerns and honing the discussion.Markets are often discussed by businesspeople, journalists, legislators, and everyday customers alike. Examples include the markets for oil, housing, bonds, employment, and a variety of commodities and services. But often, what they mean when they say "market" is ambiguous or incorrect. Since markets are a primary area of study in economics, economists strive to be as precise as possible when defining markets.

It is simplest to comprehend what a market is and how it operates by categorising individual economic entities into buyers and sellers, two significant groupings, each with a distinct purpose. Consumers who buy products and services are considered buyers, as are businesses who acquire the labour, capital, and raw materials needed to manufacture goods and services. Sellers include businesses that market their products and services, individuals who sell their labour, and owners of natural resources who lease their land or market their minerals to businesses. However, we will find it useful to think of them as simply buyers when they are purchasing something and sellers when they are selling something. It is obvious that the majority of individuals and most businesses function as both buyers and sellers. Markets are created via the interaction of buyers and sellers. A market is a group of buyers and sellers whose interactions actual or potential determine the price of a good or group of goods. For instance, in the personal computer industry, Hewlett-Packard, Lenovo, Dell, Apple, and many other companies are the sellers while consumers, families, and students are the purchasers. Keep in mind that a market encompasses more than an industry. An industry is a group of businesses that offer similar or related items. An industry is essentially the market's supply side.

Market definition, or deciding which customers and sellers should be included in a certain market, is a common topic for economists. Potential interactions between buyers and sellers might be just as significant in establishing a market as actual interactions. The gold market is one instance of this. It is doubtful that a New Yorker would fly to Zurich to purchase gold. The majority of gold purchasers in New York will only deal with local vendors. However, because the cost of moving gold is negligible in comparison to its worth, customers in New York might transfer their gold to Zurich if the costs were much lower.A commodity's price variations that are

significant might lead to opportunities for arbitrage, or the practise of paying less in one place and receiving more elsewhere. The potential for arbitrage precludes major price differences between gold in New York and Zurich and establishes a global market for the metal.Markets are the focal point of economic activity, and many of the most intriguing problems in economics have to do with how markets work.

Competitive versus Noncompetitive Markets

There are numerous buyers and sellers in a completely competitive market, meaning that neither has any influence on pricing. The majority of agricultural markets are almost completely competitive. For instance, tens of thousands of farmers grow wheat, which tens of thousands of consumers buy to make bread and other items. As a consequence, neither a single farmer nor a solitary consumer can have a big impact on the price of wheat.A lot of other markets are fiercely competitive enough to be considered excellent competitors. For instance, there are a few dozen significant manufacturers of copper on the global market. If one producer out of that many goes out of business, the effect on prices will be minimal. The same is true for a variety of different markets for natural resources, including those for coal, iron, tin, or timber.

For analytical reasons, other marketplaces with a limited number of producers may nonetheless be regarded as competitive. For instance, there are several dozen companies in the U.S. airline business, yet just a few of companies service the majority of the routes.However, for certain reasons airline markets might be seen as competitive since there is often severe rivalry among those companies. Finally, certain marketplaces have a large number of manufacturers yet lack competition, allowing individual businesses to collectively influence the price. The global oil market is one such. The OPEC cartel has controlled that market since the early 1970s. A production group that operates in concert is known as a cartel.

Market Price

Transactions between buyers and sellers are made feasible by markets. A product is sold in large quantities at a certain price. In a market with perfect competition, one price the market price will often win out. Examples are the cost of wheat in Kansas City and the cost of gold in New York. These costs are often simple to assess. For instance, the business section of a newspaper will include the price of grain, wheat, or gold each day[7]–[9]. Different businesses may set different prices for the same product in imperfectly competitive marketplaces. This may occur as a result of a company attempting to steal clients from other businesses or as a result of consumer brand loyalty, which enables certain businesses to charge more than others. For instance, two brands of laundry detergent could be priced differently in the same store. Or the same brand of laundry detergent could be sold at two different prices in the same town's supermarkets. In situations like these, we'll use the term "market price" to refer to the price that has been averaged among several brands or stores.

Most products' market pricing will change over time, and for many products, such changes may be abrupt. This is especially true for products marketed in marketplaces with fierce competition. For instance, the stock market is very competitive since there are sometimes several buyers and sellers for each stock. Anyone who has invested in the stock market is aware that the price of any given stock may change significantly in a single day and varies from minute to minute.Likewise, the cost of commodities like timber, wheat, soybeans, coffee, oil, and silver may change significantly in price over the course of a day or a week[10].

CONCLUSION

Understanding decision-making processes that include trade-offs between current and future consumption or investment possibilities is possible via the study of intertemporal choice. Making choices that maximise long-term well-being and economic consequences requires politicians, corporations, and people to have a solid understanding of this idea.market pricing will change over time, and for many products, such changes may be abrupt. This is especially true for products marketed in marketplaces with fierce competition. For instance, the stock market is very competitive since there are sometimes several buyers and sellers for each stock. Anyone who has invested in the stock market is aware that the price of any given stock may change significantly in a single day and varies from minute to minute.Likewise, the cost of commodities When making an intertemporal decision, one must weigh the advantages and disadvantages of several options. The term "time preference" describes a person's propensity for instant satisfaction versus postponed benefits. High time preference people are more likely to priorities now consumption, whilst low time preference people are more likely to be ready to wait for future advantages.

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CHAPTER 8

PUBLIC POLICY DESIGN: FUEL EFFICIENCY STANDARDS FOR THETWENTY-FIRST CENTURY

Dr. Dasinis Nathan Annette Christinal
Assistant Professor, Masters in Business Administration (E-Commerce),
Presidency University, Bangalore, India.
Email Id: annette.c@presidencyuniversity.in

ABSTRACT:

The purpose of this research project is to examine the methodologies, difficulties, and ramifications associated with the formulation of public policy. In order to solve societal concerns, shape governance structures, and produce desired results, public policy design is essential. The paper explores several public policy design methodologies, such as incremental, participative, and rationalistic models, and assesses their advantages and disadvantages. It looks at the difficulties involved in formulating policies, such as resource allocation, data analysis, stakeholder involvement, and political dynamics. The study also looks at the effects of public policy design, such as how it affects social welfare, efficiency, and equality. This research offers insights into the creation of public policies and educates evidence-based decision-making and policy formation via empirical analysis, case studies, and theoretical frameworks.

KEYWORDS:

Decision-Making, Discounting, Economics, Intertemporal Choice, Long-Term, Present, Time Preference.

INTRODUCTION

In order to increase the average fuel efficiency of domestically marketed automobiles and light trucks (including vans and sport utility vehicles), the U.S. government implemented restrictions in 1975. Over time, the CAFE (Corporate Average Fuel Economy) regulations have gotten more demanding. The Energy Independence and Security Act, which President George W. Bush signed into law in 2007, mandated that manufacturers increase fleet wide gas economy to 35 miles per gallon (mpg) by 2020. With the support of 13 automakers, the Obama administration advanced the 35 mpg goal to 2016 and set a 55 mpg objective for 2020 in 2011. Although the program's main objective is to lessen America's reliance on foreign oil, it would also have significant positive effects on the environment, including a decrease in greenhouse gas emissions.When creating a fuel efficiency programme, several crucial choices must be taken, and the majority of them include economics. The government must first assess the program's financial effect on customers.Higher fuel efficiency requirements will make cars more expensive to buy because they will cost more to produce, but they will make them cheaper to operate because they will get better gas mileage[1]–[3].

Supply

Supply elasticity varies from the long run to the short run as well. Long-term supply is much more price elastic than short-term supply for the majority of products:Businesses suffer short-

term capacity limitations and need time to develop their capacity by constructing additional manufacturing facilities and employing personnel to staff them. This is not to suggest that a sudden rise in price won't result in a short-term increase in the amount provided. By utilising their current facilities for additional hours each week, compensating employees for more work, and quickly employing some new workers, businesses may boost productivity even in the near term. But when businesses have the time to expand their facilities and recruit bigger permanent workforces, they will be able to increase production much more.Some commodities and services have zero short-run supply elasticities.

Most cities have rental housing as an example. There are only a certain amount of rental apartments available in the very near future. Therefore, a rise in demand simply causes rents to rise. Long-term rent increases without rent limits encourage the construction of new buildings and renovations to existing ones. The amount provided rises as a consequence.However, if the price incentive is high enough, companies may find methods to boost production even in the short term for the majority of items. Although it is expensive to raise production quickly due to a number of restrictions, it could take significant price increases to produce modest short-term increases in supply.

Availability And Supply

The supply of certain items is more elastic in the short term than in the long term. These products are long-lasting and can be recycled as part of the supply if prices rise. The secondary supply of metals, which comes from waste metal that is often melted down and refabricated, is an example. When copper prices rise, there is a greater motivation to turn scrap copper into new supply, which initially results in a rapid increase in secondary supply. Eventually, however, the supply of high-quality waste decreases, increasing the expense of melting, purifying, and refabricating. then secondary supply decreases.

As a result, the secondary supply's long-term price elasticity is lower than its short-term elasticity.The short- and long-term supply curves for primary (output resulting from the mining and smelting of ore and secondary copper production on a weighted average of the component elasticities, provides estimates of the elasticities for each supply component as well as the overall supply.The price elasticity of total supply is greater in the long run than in the short run since secondary supply only makes up roughly 20% of the total supply.

DISCUSSION

Consumer Behavior

The greatest way to understand consumer behaviours is in three separate steps:

1. **Consumer Preferences:** The first stage is to identify plausible explanations for why consumers would choose one item over another. We'll examine how algebraically and visually describing a consumer's preferences for different commodities.
2. **Financial Restraints:** Naturally, customers also take pricing into account. Therefore, in Step 2, we consider the fact that customers' restricted earnings limit the amount of items they may purchase. What should a customer do in this circumstance? In the third phase, we combine customer preferences and financial restrictions to arrive at the solution to this dilemma.
3. **Consumer Choices:** Because they have limited funds and preferences, customers choose to purchase combinations of things that will give them the most happiness.

The costs of different commodities will determine these combinations. The amount of an item that customers decide to buy relies on its price, therefore knowing consumer choice can help us understand demand.

The fundamentals of consumer theory are these three phases, which we shall go over in great depth in the first three parts of this chapter. After that, we'll look at a few more intriguing facets of customer behaviour. We will examine how, for instance, real observations of customer behaviour might be used to infer the nature of consumer desires. So, if a customer choose one product over a rival product with a comparable price, we may assume that they like the first product more. Similar inferences may be made from real customer choices made in reaction to changes in the costs of the different products and services that are offered for sale.

As we've seen, one indicator of how consumers' well-being develops over time is the Consumer Price Index. By providing a variety of indices that track changes in buying power over time, we explore the topic of purchasing power in further detail in this chapter. These indices play a large role in determining the costs and benefits of many social welfare programmes, making them important instruments for determining government policy in the United States.

Prior to moving forward, we must be clear about the customer behaviour assumptions we are making and determine if they are reasonable. It is difficult to contest the idea that customers have choices among the many products and services at their disposal and that their budgets restrict what they may purchase.But the idea that customers choose the combinations of products and services to purchase in order to maximise their enjoyment may be contested.

Are consumers really as logical and well-informed as economists often portray them. customers don't always make logical selections while making purchases. For instance, people sometimes make impulsive purchases while neglecting or underestimating their financial limitations and as a consequence, incurring debt.Consumers can lack confidence in their preferences, are influenced by the choices of their friends and neighbours, or simply by shifts in mood.

And even if customers act rationally, it may not always be possible for them to completely account for the variety of pricing and options that they encounter on a daily basis[4]–[6].In recent years, economists have created models of consumer behaviour that make more sensible assumptions about decision-making and rationality. Findings in psychology and allied sciences have been substantially incorporated into the study of behavioural economics. We'll go over a few significant behavioural economics findings. At this point, we only want to be clear that certain simplifying assumptions are a necessary part of our fundamental model of consumer behaviour. However, we also want to stress that this model has done a fantastic job of describing a lot of what we have actually seen in terms of consumer demand and choice. As a consequence, this model is a fundamental "workhorse" of economics and is often utilised in sectors that are connected to economics, such as finance and marketing.

The Value of Information

Prior to moving forward, we must be clear about the customer behaviour assumptions we are making and determine if they are reasonable. It is difficult to contest the idea that customers have choices among the many products and services at their disposal and that their budgets restrict what they may purchase.But the idea that customers choose the combinations of products and services to purchase in order to maximise their enjoyment may be contested. Are consumers

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Consumers can lack confidence in their preferences, are influenced by the choices of their friends and neighbours, or simply by shifts in mood. Even if customers act rationally, it may not always be possible for them to completely account for the variety of pricing and options they see on a daily basis.In recent years, economists have created models of consumer behaviour that make more sensible assumptions about decision-making and rationality. Findings in psychology and allied sciences have been substantially incorporated into the study of behavioural economics. In Chapter 5, we'll go over a few significant behavioural economics findings. At this point, we only want to be clear that certain simplifying assumptions are a necessary part of our fundamental model of consumer behaviour. However, we also want to stress that this model has done a fantastic job of describing a lot of what we really see in terms of consumer demand and choice. As a consequence, this model is a fundamental "workhorse" of economics and is often utilised in sectors that are connected to economics, such as finance and marketing.

Assets

An asset is anything that generates income or benefits for its owner. Assets include things like a house, an apartment complex, a savings account, and stock in General Motors. For instance, a house offers its owner a flow of housing services and, if the owner chose not to live there, might be leased out to generate income. Similar to that, flats may be leased out, giving the building's owner a steady stream of rental money. A savings account provides interest, which is typically reinvested in the account on a daily or monthly basis.The income one obtains from owning assets might come in the form of a direct payment, such the rent from an apartment complex: The renters give the landlord a cheque for the rent each month. The dividend on common stock shares is an additional instance of express payment: A quarterly dividend payment is made to the holder of a share of General Motors stock every three months.

However, there are occasions when an asset's financial flow is implicit and takes the shape of a rise or reduction in the asset's price or value. A capital gain is when the value of an asset rises; a capital loss is when the value falls. For instance, an apartment building's worth could rise when a city's population rises. The building's owner will then realise a capital gain in addition to the rental revenue. Since no money is actually received until the building is sold, the capital gain is not recognised until then. There is, however, an implicit monetary flow because the building could be sold at any time. Owning General Motors shares also has certain underlying financial benefits. Daily fluctuations in the stock price result in gains or losses for shareholders.

Risky and Riskless Assets

A hazardous asset offers a financial flow that is at least somewhat unpredictable. In other words, the direction of the money flow cannot be predicted precisely in advance. A share of stock in General Motors is a prime illustration of a hazardous asset: You can't predict whether the stock price will increase or decrease over time, and you can't even be certain that the firm will keep paying the same or any dividend per share. The majority of other assets are dangerous, despite the fact that the stock market is often associated with risk[7]–[9].

One example is a residential complex. You cannot predict how much land prices will increase or decrease, whether a building will always be completely occupied, or even if tenants would pay their rent on time. Another example is corporate bonds, where the issuing company may declare bankruptcy and stop paying bondholders' interest and principal. Even U.S. government bonds with a 10- or 20-year maturity date carry risk. Although it is very improbable that the government would declare bankruptcy, the value of the bonds might be adversely affected if inflation rates suddenly rise, making future interest payments and the ultimate repayment of principal worth less in real terms.

A riskless or risk-free asset, on the other hand, generates a predictable cash flow. Treasury bills, or short-term U.S. government bonds, are essentially risk-free. There is virtually little danger from an unanticipated rise in the rate of inflation since they mature in a few months. Additionally, you may have some confidence that the US government won't breach the bond's terms by refusing to reimburse the holder when it's due. Passbook savings accounts and short-term certificates of deposit are other instances of riskless or almost riskless investments.

Asset Returns

Due of the cash flow that assets provide, people want to acquire and keep them. It is useful to consider this financial flow in relation to an asset's price or value when comparing different assets to one another. The overall cash flow an asset generates, including capital gains or losses, expressed as a percentage of its purchase price is its return. For instance, a bond with a current value of $1,000 that will pay out $100 this year and every year will have a 10% return.11 If an apartment block had a value of $10 million last year, rose to $11 million this year, and generated $0.5 million in rental revenue (after expenditures), it would have generated a return of 15% over the previous year. A share of General Motors stock that started the year at a value of $80 and ended the year at a value of $72 would have produced a return of -5 percent (the dividend yield of 5% minus the capital loss of 10%).People often aim to outpace inflation when investing their resources in stocks, bonds, real estate, or other assets. They can thus purchase more in the future by deferring consumption than they can by using up all of their money right once. As a result, we often refer to an asset's return in real, or inflation-adjusted, terms. The simple (or nominal) return on an asset is equal to that return minus the inflation rate. For instance, our bond, apartment block and share of GM stock have all generated real returns of 5%, 10% and 10%, respectively, with an annual inflation rate of 5%[10].

CONCLUSION

Understanding decision-making processes that include trade-offs between current and future consumption or investment possibilities is possible via the study of intertemporal choice. Making choices that maximise long-term well-being and economic consequences requires politicians, corporations, and people to have a solid understanding of this idea.When making an intertemporal decision, one must weigh the advantages and disadvantages of several options. The term "time preference" describes a person's propensity for instant satisfaction versus postponed benefits. High time preference people are more likely to prioritise now consumption, whilst low time preference people are more likely to be ready to wait for future advantages.A critical step in forming governance frameworks and addressing social concerns is public policy formulation. The purpose of this research project was to examine the methods, difficulties, and consequences of designing public policies.The research showed that many models, such as rationalistic, incremental, and participatory methods, might be used to approach the creation of public

policies. In order to get the best results, the rationalistic approach places a strong emphasis on evidence-based decision-making and methodical study of options. The incremental approach emphasises gradually improving upon current policies and making tiny improvements. The participatory approach places a strong emphasis on the public's and stakeholders' participation in the creation and implementation of policies.

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CHAPTER 9

DETERMINATION OF BUBBLES IN ECONOMICS: UNDERSTANDING FORMATION, DETECTION AND IMPLICATIONS

Dr. Mounica Vallabhaneni
Assistant Professor, Department of Commerce and Economics,
Presidency University, Bangalore, India.
Email Id: mounicav@presidencyuniversity.in

ABSTRACT:

The decision-making process that involves balancing current and future consumption or investment possibilities is referred to as an intertemporal choice. The ideas of time preference, discounting, and variables affecting intertemporal decision-making are all explored in the research. In order to make choices that maximise long-term well-being and economic results, politicians, corporations, and people need to have a solid understanding of intertemporal choice.his research project intends to analyse how economic bubbles are identified and investigate the elements that lead to their creation, identification, and effects. Bubbles are instances when asset prices drastically depart from their basic values, resulting in unsustainable price rises and abrupt drops. The research explores market sentiment, behavioural finance, and investor behaviour as theories and models for understanding bubble creation. It looks at the many techniques and tools for bubble spotting, including historical price patterns, price-to-book ratios, and price-to-earnings ratios. The study also examines how bubbles affect the financial markets, investor behaviour, and overall economic stability. This research offers insights into the identification of bubbles and informs evidence-based decision-making and policies surrounding market regulation, risk management, and investor protection via empirical analysis, case studies, and theoretical frameworks.

KEYWORDS:

Decision-Making, Discounting, Economics, Intertemporal Choice, Long-Term, Present, Time Preference.

INTRODUCTON

The stock prices of several Internet firms increased significantly between 1995 and 2000. What was the cause of these rapid price rises? One may argue that these price rises were supported by fundamentals, as many stock analysts, financial advisers, and regular investors did at the time. Particularly when high-speed Internet connection became more widely accessible, many individuals believed that the Internet's potential was almost limitless. In any case, an increasing number of products and services were being purchased online from businesses like Amazon.com, Craigslist.org, Ticketmaster.com, Fandango.com, and a number of others. In addition, a growing number of individuals started reading the news online rather than purchasing print editions of newspapers and magazines, and a growing number of online resources, like Google, Bing, Wikipedia, and WebMD, increased the amount of information that was accessible. As a consequence, businesses started to move an increasing amount of their advertising from television and newspapers to the Internet.

Yes, the majority of us now live quite different lives thanks to the Internet. (Some of you may even be reading this book right now in its electronic form, which you got from the Pearson website and, presumably, purchased.) But does it imply that every business with a ".com" at the end of its name would undoubtedly be successful in the future? Most likely not. Yet many investors—or maybe "speculators" would be a better term—purchased shares in Internet firms at exorbitant prices, prices that were getting harder and harder to justify on the basis of fundamentals, that is, on logical estimates of future profitability. The end effect was the creation of the Internet bubble, a surge in the values of Internet stocks driven more by expectations of future price growth than by the realities of company profitability. When people began to realise that these enterprises' profitability was far from a given and that rising prices may equally lead to falling ones, the bubble popped[1]–[3].

Irrational behaviour often leads to bubbles. People become unable to think clearly. They purchase something because they feel that a profit will be guaranteed since the price has been rising and they expect it will continue to rise (perhaps pushed by their friends). These folks frequently respond, "Yes, but I will sell before the price drops," when asked whether the price would eventually decline. Additionally, if you press them by asking how they will know when the price is set to decrease, they can respond, "I'll just know," to your question. However, the majority of the time they won't be aware; they'll sell after the price has decreased, losing at least some of their investment.There may be a bright sidepossibly they will learn something about economics from the experience.In spite of the fact that individuals may lose money, bubbles often do little long-term harm to the economy as a whole. However, that isn't always the case.Long-lasting housing price bubble in the US that broke in 2008 cost big banks money because they offered mortgages to homebuyers who couldn't afford to pay their monthly payments but believed that prices would keep increasing. Large government bailouts were granted to some of these banks to prevent them from falling down, but many homeowners were less lucky and lost their houses to foreclosure. The United States had its worst recession since the 1930s Great Depression at the end of 2008. This was partially caused by the house price bubble, which was by no means innocent.

Informational Cascades

Ajax is a biotech startup developing a completely new method to alleviate chronic boredom, a condition that often affects economics students. The company's future are tough for you to assess, but $20 looks like a fair price. But as you can see, the share price is rising, first to $21, then to $22, and finally to $25. In fact, several of your buddies just invested $25. The cost has increased to $30. Other investors must be knowledgeable. Perhaps they sought advice from biochemists, who are more qualified to assess the company's possibilities. So you choose to pay $30 for the shares. You acted in accordance with your belief that other investors' actions were motivated by favourable information.Was it logical to purchase Ajax stock for $30 or were you only investing in a bubble? It could in fact make sense. Since other investors likely done their best to evaluate the firm, it is fair to assume that their analysis may have been more complete or educated than yours. Thus, the activities of other investors may be instructive and cause you to logically modify how much you think the firm is worth.

Be aware that in this instance, your investment choices aren't based on the basic knowledge you've acquired (such the possibility that Ajax's R&D would be successful), but rather on the choices made by others.You should also be aware that you are implicitly assuming that (i) these

other people's investment decisions are based on fundamental information that they have learned; (ii) these other people's investment decisions are based on the investment decisions of others who, in turn, are based on the investment decision; or (iii) these other people's investment decisions are based on the investment decision of others who, in turn, are based on the investment decision of others. You see what I mean. The "others" at the end of the chain may have made their investment choices based on unreliable information that was no more illuminating than the data you started with when you started considering Ajax. In other words, depending on very little basic knowledge, your own investing selections may be the outcome of an informational cascadeactions leading to other actions leading to further actions, etc.

An informational cascade may produce a bubble that is reasonable in the sense that there is reason to believe that investing in the bubble would result in a profit. The rationale for this is that an investor farther down the chain will expect to profit if investors earlier in the chain did, in fact, acquire favourable information and base their judgements on it. However, there will be a significant amount of risk involved, and it is possible that at least some investors will undervalue that risk.

DISCUSSION

Behavioral Economics

Remember that the fundamental theory of consumer demand is predicated on three tenets: (1) consumers have clear preferences for some goods over others; (2) consumers are constrained by their means of subsistence; and (3) given their preferences, restricted means of subsistence, and the prices of various goods, consumers select combinations of goods that will maximise their satisfaction (or utility). However, these predictions are not always accurate: Consumer decisions are not always utility-maximizing, and preferences are not always obvious or may change depending on the circumstances in which they are made.

We may perhaps get a better grasp of consumer demand (as well as company choices) if we made more accurate and thorough assumptions about human behaviour. This has been the goal of behavioural economics, a rapidly expanding area that has enriched and expanded the field of microeconomics.23 We start this issue by presenting a few instances of customer behaviour that defy simple explanation by the fundamental utility-maximizing assumptions we have so far depended on:

You stop at the hardware shop to get a snow shovel since there was just a significant blizzard. The shovel cost $20, as was your expectation; this is what the shop's standard pricing is. You discover, however, that the shop has abruptly increased the cost to $40. Although you would anticipate a price hike due to the storm, you believe that the shop is attempting to take advantage of you by doubling the price. You choose not to purchase the shovel out of spite.24

1. After becoming sick of being cooped up at home by the snow, you choose to go on a rural holiday. You have lunch at a highway eatery along the route. Even though you don't think you'll go back to that restaurant again, you feel it is just and fair to provide a 15% tip in gratitude for the excellent service you experienced.
2. Because the price is less expensive than the price at your neighborhood bookshop, you purchase this textbook from an online retailer. You don't include delivery costs, however, when comparing rates[4]–[6].

Each of these instances shows probable behaviour that is inexplicable by a model that is just predicated on the fundamental presumptions. Instead, in order to strengthen our fundamental beliefs about consumer behaviour, we must include findings from psychology and sociology. With the help of these revelations, we will be able to explain more complicated consumer preferences, the application of basic principles in decision-making, and the common difficulty in comprehending probability laws.Three categories of modifications to the conventional model of consumer preferences and demand can be identified: the propensity to value goods and services in part according to the environment one is in; the concern with the fairness of an economic transaction; and the application of straightforward rules of thumb to simplify complicated economic decisions. We look at each of them individually.

Fairness

Sometimes, even when there is no money or other tangible advantage, people do action because they believe it to be just or fair. Giving to charities, doing volunteer work, or leaving tips at restaurants are a few examples. Fairness also had an impact on customer behaviours in our hypothetical snow shovel purchase.At first appearance, fairness doesn't seem to be covered by our fundamental consumer theory. However, we may often adjust our demand models to take into consideration how fairness affects customer behaviours. Let's go back to our first snow shovel example to understand how. In that illustration, shovels had a $20 market price, but retailers boosted their prices to $40 following a snowfall (which shifted the demand curve). However, several customers thought they were being unjustly gouged and chose not to purchase a shovel. The demand curve D1 is valid in fair weather. Due to the fact that many customers purchase shovels in anticipation of snow, stores charge $20 for them and sell a total of Q1 shovels each month. In reality, some consumers would have been ready to pay somewhat more for a shovel (the top section of the demand curve), but because the market price is $20, they are not required to. The demand curve then moves to the right when the snowfall arrives. Demand would have climbed to Q2 if the price had stayed at $20. However, observe that the new demand curve (D2) does not climb as high as the previous one. Many people could believe that a price rise of, say, $25 is reasonable, but one considerably more than that would be unjust gouging. Since no shovels can be sold for much more than $30, the new demand curve becomes very elastic at prices over $25.

Note how fairness is important in this situation. Some customers would have been prepared to shell out $30 or even $40 for a shovel under normal circumstances. Although they are aware that the price has always been $20, they are unwilling to purchase because they believe that a sudden price hike after a blizzard is unjust price gouging. Also take note of how we might adjust conventional demand curves to take consumer sentiments towards fairness into consideration.The ultimatum game offers yet another illustration of fairness. Imagine being given the opportunity to split 100 $1 banknotes with a stranger you will never see again under the following conditions: You start by suggesting splitting the cash between you and the stranger. Your proposition will get an affirmative or negative response from the stranger. You each get the suggested portion if he agrees. If he declines, you both lose out. What ought you to do?

Our core idea gives a simple response to this question: more money = greater usefulness. You should suggest that you get $99 and the other person receives only $1. Additionally, the respondent should be glad to accept this offer since $1 is more than what he had before and would get if he refused it (in both situations $0). It's a win-win situation for the two of

you.However, the majority of those faced with this decision are reluctant to make such an offer because they believe it to be unjust, and many "strangers" would decline the offer. Why? The outsider could think that because you both had the $100 windfall opportunity, a straightforward and equitable distribution would be 50/50 or something like.

Perhaps the stranger will decline your gift of a dollar to demonstrate to you that greed is not acceptable behaviour. It would be logical for you to make a larger offer if you think the stranger would feel this way. Actually, when this game is played experimentally, common share offers often fall between 67/33 and 50/50, and such offers are typically accepted.The ultimatum game demonstrates how fairness may impact financial choices. Fairness issues may, unsurprisingly, influence discussions between businesses and their employees. Because the management think workers should have a decent standard of life or because they wish to create a positive work environment, a company may pay its employees more.Those who do not get a decent salary may not put forth much effort in their employment. it will be shown that the "efficiency wage theory" of labour markets, which disregards fairness issues, may also explain why employers pay their employees higher-than-market salaries.) Fairness has an impact on how businesses set their pricing as well, which helps to explain why businesses find it easier to raise prices in reaction to rising expenses than to rising demand.

Fortunately, the fundamental model of consumer behaviour allows for the consideration of fairness issues. People who relocate to San Francisco will be less ready to pay the maximum amount for rental accommodation if they feel that high flat rates are unjust. If enough people have this opinion, the ensuing drop in demand will result in reduced rental costs. Similar to this, if a sufficient number of employees believe that their pay is unfair, there will be a decrease in the supply of labour, and wage rates would rise.

Rules of Thumb and Biases in Decision Making

Numerous daily and economic decisions may be rather difficult, particularly when they concern areas with which we are unfamiliar. People often use mental shortcuts or rules of thumb in certain situations to aid in decision-making. You used a mental shortcut in the tipping scenario when you chose to leave a 15% tip. The use of such rules of thumb, however, has the potential to incorporate bias into our economic decision-making, which is something that our fundamental model forbids.

Anchoring

The mental models we use while making judgements regularly change depending on the situation and the facts at hand. Imagine, for instance, that you have recently been asked to donate to a brand-new neighbourhood charity. The organisation offers the following options rather than asking for a donation of any size: $20, $50, $100, $250, or "other."

These recommendations are meant to persuade you to anchor your final gift. The term "anchoring" describes the influence that a recommended (perhaps unrelated) piece of information may have on your choice. Instead of attempting to figure out exactly how much to give, let's say $44.52, and not wanting to seem frugal, one may just write a cheque for the next higher category, which is $50. Another person may choose the lowest amount listed, $20, if they merely want to provide a token gift of $10[7]–[9].In both situations, anchoring may influence people's decisions to make bigger gifts.The fact that so many price tags finish in 95 or 99 is also no

accident.Marketers are aware that customers often emphasise the first digit of pricing and categorise costs into ranges such as "under $20" or "over $20." Therefore, $19.95 appears considerably less expensive than $20.01 to the buyer, who may not be thinking too deeply[10].

CONCLUSION

the study of intertemporal choice offers important insights into the trade-offs that occur throughout the decision-making process between possibilities for the now and the future. Stakeholders may make well-informed decisions that maximize long-term well-being and economic benefits by comprehending time preference, discounting, and the variables impacting intertemporal choices. A fundamental idea in economics, intertemporal choice aids people and organizations in navigating the difficulties of making plans for the future while taking into account immediate needs and preferences.According to the research, asset prices that dramatically vary from their underlying values are signs of a bubble. Investor conduct, market emotion, and the herd instinct are all factors that contribute to bubble creation. Theories of behavioural finance place a strong emphasis on the psychological biases that fuel asset price bubbles, such as overconfidence or a fear of losing out. Excessive optimism or pessimism in the market may exaggerate price changes and drive bubble dynamics. Bubble creation may also be influenced by the herd mentality, in which investors copy the behaviour of others without carefully analysing underlying factors.

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CHAPTER 10

UNDERSTANDING PRODUCTION, PROFITABILITY, AND EFFICIENCY

Mr. Yelahanka Lokesh
Assistant Professor, Department of Commerce and Economics,
Presidency University, Bangalore, India.
Email Id:lokesh.yr@presidencyuniversity.in

ABSTRACT:

The concepts of production function, profitability, and efficiency with regard to a firm's production decisions, variables influencing a firm's production decisions, and their effects. Key factors such input prices, technology, economies of scale, and market demand are examined in the research. For managers, policymakers, and academics, understanding a firm's production choices is crucial to maximizing resource allocation, cost effectiveness, and economic consequences.This study's objective is to examine the economic bubbles that exist and how they are identified as well as their causes, consequences, and contributing elements. Bubbles are instances when asset prices drastically depart from their basic values, resulting in unsustainable price rises and abrupt drops. The research explores market sentiment, behavioural finance, and investor behaviour as theories and models for understanding bubble creation. It looks at the many techniques and tools for bubble spotting, including historical price patterns, price-to-book ratios, and price-to-earnings ratios. The study also examines how bubbles affect the financial markets, investor behaviour, and overall economic stability. This research offers insights into the identification of bubbles and informs evidence-based decision-making and policies surrounding market regulation, risk management, and investor protection via empirical analysis, case studies, and theoretical framework.

KEYWORDS:

Economies, Input Costs, Production Decisions, Production Function, Profitability, Technology.

INTRODUCTION

by segmenting customer behaviour into three phases. We started by outlining the proper way to describe customer preferences. Second, we took into consideration the financial limits that customers confront. Third, we observed that customers may choose combinations of items to increase their level of happiness depending on their tastes and financial limitations. Similar to how customers make their purchase choices, corporations also make production decisions, which may also be characterized in three steps:

1. **Production Technology:** We want a comprehensible framework for explaining how inputs such as labour, money, and raw materials can be converted into outputs such as automobiles and TVs. The corporation may create a certain level of output by employing various combinations of inputs, just as a customer can get a certain degree of pleasure by purchasing different combinations of items. For instance, an electronics company may make 10,000 TVs every month utilising either a lot of labour (e.g., people assembling the televisions by hand) and very little capital, or a lot of labour and a highly automated facility.

2. **Cost Restrictions:** Businesses must consider the costs of labour, capital, and other inputs. The company will be worried about the cost of manufacturing, just as a customer is confined by a certain budget. The company that makes 10,000 TVs every month, for instance, would aim to create them in a manner that minimises its overall production cost, which is influenced in part by the cost of the inputs it utilises.
3. **Options for Input:** The company must decide how much of each input to employ in creating its output based on its production technique, the costs of labour, capital, and other inputs, as well as other factors. Just as a buyer weighs the costs of several products, The company must consider the costs of various inputs when determining how much of each input to utilise when determining how much of each item to purchase. If our electronics company is based in a nation with low wage rates, it may choose to build TVs with a lot of labour and little capital [1]–[3].

Firms and Their Production Decisions

The concept of a company as we know it today is very recent. Prior to the middle of the nineteenth century, the majority of production was carried out by farmers, artisans, people who created apparel and wove fabric, as well as merchants and dealers who purchased and sold a variety of items. In the United States, Europe, and everywhere else in the globe, this was accurate. The idea of a companyrun by managers independent of the company's owners, who recruit and oversee a sizable workforcedid not even exist.

Only in the second half of the 19th century did modern businesses begin to take shape. Today, we assume all businesses. We find it difficult to picture the manufacturing of cars without major corporations like Ford and Toyota, the production of oil and natural gas without Exxon-Mobil and Shell, or even the manufacturing of breakfast cereal without Kellogg and General Mills. But pause for a second and consider if we really need businesses to provide the products and services that we frequently use. If employees functioned autonomously, there would be a critical lack of a form of coordination offered by businesses. The necessity for every employee to haggle over the duties they will do and the wages they will get is eliminated by businesses. Employers may avoid this kind of negotiating by using managers to oversee the work of salaried employees.

These managers instruct employees on what to do and when to do it in exchange for a weekly or monthly wage.Of course, there is no assurance that a business will run well, and there are several instances of businesses that perform really poorly. Managers may make choices that are in their own interests but not in the best interests of the company since they are unable to constantly keep an eye on what employees are doing. As a consequence, organisational economics and the theory of the business have gained prominence in the field of microeconomic study. The theory contains both constructive explaining why managers and employees act in certain ways and normative explaining how businesses might be best organised to run as effectively as possible parts. Talk about some of the theory's components. At this stage, we just want to emphasise the fact that businesses exist because they make it possible to create things and services far more effectively than would be otherwise feasible.

The Technology of Production

At the most basic level, businesses transform inputs into outputs or goods. The core function of a company is this manufacturing process, which converts inputs into outputs. All materials that the company needs to employ in the manufacturing process are considered inputs, also known as

elements of production. For instance, in a bakery, inputs consist of labour provided by employees, raw ingredients like wheat and sugar, and capital spent in the ovens, mixers, and other machinery required to create products like bread, cakes, and pastries.

As you can see, we may categorise inputs into three broad groups: labour, materials, and capital, each of which may have additional more specific subcategories. Carpenters, engineers, and agricultural labourers are examples of skilled and unskilled labour inputs, together with the managerial initiative of the company. Steel, polymers, energy, water, and any other things that the company purchases and converts into finished goods are examples of materials. Inventories, along with real estate, construction materials, and other equipment are all considered capital.

The Production Function

Businesses may use different mixes of labour, materials, and capital to transform inputs into outputs in a number of ways. A production function may be used to explain the connection between the inputs into the production process and the output that is produced. A production function shows the maximum amount of output q that a company may create for each unique set of inputs. Despite the fact that in reality, organisations employ a broad range of inputs, we will make our study simple by concentrating on only two: labour L and capital K. Consequently, we may format the production function as This equation connects the quantities of the two inputs, labour and capital, to the quantity of the output. The production function may, for instance, specify the volume of personal computers that can be produced annually in a 10,000-square-foot facility with a certain level of assembly-line labour. Or it may refer to the crop that a farmer can produce with a certain number of people and pieces of equipment.It's crucial to remember that inputs and outputs are both flows. For instance, the company that makes our PCs employs a particular quantity of labour annually to create a given volume of computers. Although the company may own its equipment, we might consider the cost of using that equipment over the course of a year as a cost to the company. In order to make things easier, we usually omit the mention of time and instead focus only on labour, capital, and output levels. However, unless otherwise stated, we refer to the annual consumption of labour and capital as well as the annual production.

The output may be created in a variety of ways since the production function permits inputs to be blended in different amounts. This might entail utilising more capital and less labour for the production function in equation, or vice versa. For instance, wine may be made in a capital-intensive method with machinery and few employees, or in a labor-intensive one with numerous workers.Be aware that equation only applies to a certain technology, or to a specific level of understanding of the potential ways for converting inputs into outputs.

A company can produce more with a given set of inputs as technology improves and the manufacturing process evolves. An increased assembly line speed, for instance, may enable a hardware manufacturer to crank out more high-speed computers in a given amount of time.When a business performs effectively, that is, when it makes the best use of each combination of inputs, production functions define what is theoretically achievable. Although it is not necessary to assume that manufacturing is always technically efficient, it is acceptable to anticipate that profit-driven businesses won't squander resources [4]–[6].

DISCUSSION

The Short Run versus the Long Run

A company must gradually modify its inputs to create its product with varying labour and capital inputs. A new factory has to be designed, constructed, and equipped with machinery and other capital goods. These tasks might easily take a year or more to do. As a consequence, the company is unlikely to be able to replace much capital for labour if we are looking at production choices over a short period of time, such as a month or two.It is crucial to differentiate between the short and long term when analysing production because enterprises must take into account whether or not inputs can be modified, and if they can, over what timeframe. The term "short run" refers to a time frame during which one or more manufacturing factors' amounts cannot be altered. In other words, at least one variable that cannot be changed exists in the short term; this variable is known as a fixed input. The length of time required to make all inputs variable is known as the long run.

The kind of choices that businesses may make are considerably different from those made in the long term, as one would anticipate. In the short term, businesses alter the degree to which they use a certain piece of equipment, while in the long term, they alter the plant's size. All fixed inputs in the short run are the results of earlier long-run choices based on projections of what a corporation may create and sell economically. The short run and the long run are not separated by a fixed length of time, like a year. Instead, one must make a case-by-case distinction between them. For an automotive company or petrochemical plant, the long run may be five or 10 years, whereas it might just be a day or two for a child's lemonade shop. We'll see that businesses may alter the quantities of every input in the long term to reduce manufacturing costs. However, before we address this general scenario, we first analyse the short run, in which there is only one variable in the manufacturing process. Assumedly, labour is a variable input and capital is a fixed input.

Production with One Variable Input (Labor)

A company must weigh the benefit from a given input's purchase against its cost when determining how much of it to purchase. By concentrating on the increased output that emerges from an incremental increase to an input, it may often be helpful to examine the benefit and the cost on an incremental basis. In other circumstances, it is helpful to compare things on an average basis while taking the outcome of significantly raising an input into account. We shall examine both the advantages and disadvantages.

When labour is flexible but capital is fixed, the only way a business can increase production is by increasing labour input. Consider that you are in charge of a clothes manufacturing, for instance. Despite having a certain quantity of machinery, you may employ more or less labour to sew and operate the equipment. You must choose how many workers to employ and how many garments to manufacture. You must determine whether or not the quantity of output q rises as labour input L increases in order to make the choice.

The output that can be generated in a month with various labour and capital inputs set at 10 units is shown in the first three columns. The quantity of labour is shown in the first column, fixed capital is displayed in the second, and total output is displayed in the third. A zero labour input results in a zero output. As labour is increased up to an input of 8 units, output then rises. After

that, overall production decreases: Although originally each unit of labour could benefit more and more from the equipment and plant already in place, at a certain point, more labour became ineffective and even detrimental. Although 10 individuals could get in each other's way, five workers can operate an assembly line more effectively than two.

labour input unit. By dividing the entire output q by the total labour input L, the average product is determined. The average product of labour calculates the workforce productivity of the company by calculating the typical production of each employee. In our illustration, the average output initially rises butAs the labour input exceeds four, it drops. This is the extra output that was created when the labour input was raised by one unit. An extra production of 30 (i.e., 60-30) units is produced, for instance, when the capital is fixed at 10 units and the labour input is increased from 2 to 3. The change in output q that results from a 1-unit increase in labour input L is known as the marginal product of labour, or q/L.

Keep in mind that the quantity of capital used determines the marginal output of labour. The marginal product of labour would probably rise if the capital input went from 10 to 20. Why? Because more employees will probably be more effective if they have more resources at their disposal. The marginal product, like the average product, rises initially before declining in this instance, after the third unit of labour.

The Average Product of Labor Curve

the geometric connection between the total product and the average and marginal product curves. The entire product is divided by the amount of labour input to get the average product of labour. For instance, at B, the average output is equal to 60 divided by 3, or 20 units of output for every unit of labour input. However, this ratio precisely matches the slope of the line from the origin to B. The slope of the line traced from the origin to the appropriate point on the total product curve, in general, gives the average product of labour.

The Law of Diminishing Marginal Returns

majority of production processes, there is a declining marginal product of labour as well as a diminishing marginal product of other inputs. According to the rule of decreasing marginal returns, there will ultimately come a time when the contributions to output decrease as the usage of an input rises in equal increments with other inputs held constant. Extra labour contributes significantly to production when labour input is modest and capital is constant, often as a result of employees being free to focus on specialised jobs. But eventually, the law of declining marginal gains comes into play: When there are too many employees, some of them lose their effectiveness, and the labor's marginal output decreases [7]–[9]. When at least one input is fixed, the rule of declining marginal returns often applies in the short term. It may, however, also be relevant in the long term. Even when inputs fluctuate over time, a manager could still wish to consider production options for which one or more inputs remain constant.there are only two possible plant sizes, and management must choose which to construct. The management would then be interested in learning when declining marginal returns will begin to apply to each of the two possibilities.

The rule of declining marginal returns should not be confused with potential changes in labour quality as labour inputs rise as would probably happen, for instance, if the most highly qualified labourers are employed first and the least qualified subsequently. Since all labour inputs are

considered to be of similar quality in our theory of production, falling marginal returns are caused by restrictions on the use of other fixed inputs such as equipment rather than a loss in worker quality. Don't mistake declining marginal returns for negative returns either. The law of diminishing marginal returns refers to a decreasing marginal product, which is not always a bad thing.For a certain industrial technique, the law of declining marginal returns is applicable. The total product curve in may move higher over time due to innovations and other technological advancements, allowing for the production of more output from the same inputs. The output curve is initially represented by O1, but as technology advances, the curve may move higher, first to O2 and then to O3.Consider, for instance, that technical advancements are being achieved when labour is added to agricultural output throughout time. Genetically modified crops that are resistant to pests, stronger and more efficient fertilizers, and improved agricultural machinery are a few examples of these advancements. Output shifts from A (with an input of 6 on curve O1) to B (with an input of 7 on curve O2) to C (with an input of 8 on curve O3) as a consequence [10].

CONCLUSION

A firm's production choices have a significant impact on how well it performs economically. Input prices, technology, economies of scale, and market demand are just a few examples of the variables that businesses may take into account to optimise their production processes, reduce costs, and boost profitability. Making educated choices about resource allocation, technology adoption, and production volume is possible for businesses when they have a solid understanding of the production function and the interactions between inputs and outputs.The rule of declining marginal returns should not be confused with potential changes in labour quality as labor inputs rise (as would probably happen, for instance, if the most highly qualified labourers are employed first and the least qualified subsequently). Since all labour inputs are considered to be of similar quality in our theory of production, falling marginal returns are caused by restrictions on the use of other fixed inputs (such as equipment) rather than a loss in worker quality. Don't mistake declining marginal returns for negative returns either.

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CHAPTER 11

DETERMINATION OF LABOR PRODUCTIVITY

Dr. Dasinis Nathan Annette Christinal
Assistant Professor, Masters in Business Administration (E-Commerce),
Presidency University, Bangalore, India.
Email Id: annette.c@presidencyuniversity.in

ABSTRACT:

The purpose of this research project is to examine how labour productivity is determined, along with the variables that affect it, the measuring techniques used, and the ramifications for the economy and company. A crucial indicator of efficiency and output per labour input in industrial processes is labour productivity. The neoclassical production function, the human capital theory, and technological improvements are only a few of the theories, models, and frameworks the research dives into to analyse labour productivity. It looks at the elements that affect labour productivity, such as management practises, skill level, training, technology adoption, and work organisation. The study also examines the techniques and metrics for calculating labour productivity, such as production per employee, value added per hour, and total factor productivity. It also looks at the effects of labour productivity on competitiveness, workforce development, and economic growth. This research offers insights into how labour productivity is calculated and informs the formation of policies for workforce management, skill development, and productivity improvement via empirical analysis, case studies, and theoretical frameworks.

KEYWORDS:

Determinants, EconomicPerformance, Labor Efficiency, Labor Productivity, Measurement.

INTRODUCTION

Despite the fact that this is a microeconomics textbook, many of the ideas presented here serve as a basis for macroeconomic analysis. Labour productivitythe average output of labour for a whole industry or for the economy as a wholeis of special interest to macroeconomists. In this part, we talk about labour productivity in the US and many other nations.This subject is intriguing in and of itself, but it also serves to highlight a connection between micro- and macroeconomics.The average product is reasonably simple to measure (you just need to know the total labour input and total output), since it measures output per unit of labour input. Comparing labour productivity across industries and over a long period of time for one industry may be informative. But the true level of life that a nation can provide for its residents is determined by labour productivity, which is why it is so crucial.

Productivity and living standards The level of life and labour productivity are straightforwardly related. An economy's total output of products and services, including salaries, capital rental payments, and company profit, is equal to the total value of the commodities and services it produces in any given year. These factor payments are eventually given to consumers as wages, salaries, dividends, or interest payments. As a consequence, consumers as a whole can only raise their overall production level in order to increase their consumption rate over time[1]–[3].

An important topic of economics study is figuring out what factors lead to increases in productivity. We do know that increasing the stock of capital, or the total quantity of capital available for use in production, is one of the most significant factors contributing to increase in labour productivity. Each worker may create more output per hour worked if there is more and better equipment available due to an increase in capital. Technological advancement, i.e., the creation of new technologies that enable labour (and other inputs of production) to be employed more efficiently and to generate new and higher-quality items, is a significant source of rise in labour productivity.The levels of labour productivity and the rates of productivity increase have varied greatly between nations, Understanding these variations is crucial given the major role that production plays in altering our levels of life.

Flexibility of Input

Isoquants demonstrate the adaptability of businesses' decision-making processes: Typically, they can produce a certain result by switching out one input for another. It's crucial for managers to comprehend how this flexibility works. For instance, fast-food businesses lately experienced a lack of youthful, low-wage workers. In response, businesses have automated, added self-service salad bars, and introduced more advanced culinary equipment. Additionally, they have hired senior citizens to fill open posts. Managers may pick input combinations that minimise cost and maximise profit by taking into consideration this flexibility in the manufacturing process,

Marginal returns are declining

Even if labour and capital are both changeable over the long term, it might be helpful for a company to question what happens to production when one input is raised while the other input is maintained constant. By sketching a horizontal line at, say, level three of capital, we can understand why there are declining marginal returns to labour. As labour is increased, we see that the levels of output from each isoquant rise less and less with each new unit of labour. For instance, if the number of hens is raised from one to two (from A to B), the production rises by 20 (from 55 to 75). However, production only rises by 15 (from 75 to 90) when labour is raised by another unit (from B to C). As a result, both in the long and short terms, labour has declining marginal returns. The isoquant must get steeper when more capital is introduced in lieu of labour and flatter when more labour is added in place of capital since increasing one element while maintaining the other constant ultimately results in decreasing incremental output.Additionally, capital has declining marginal returns. The marginal product of capital falls as capital increases while labour is fixed. For instance, when labour is maintained constant at 3 and capital is raised from 1 to 2, the marginal product of capital initially equals 20 (75 - 55), but it decreases to 15 (90 - 75) when capital is expanded from 2 to 3.

Replacement of Inputs

Whenever there are two inputs that may be changed, a manager should think about switching one input for another. The slope of each isoquant shows how, while keeping output constant, the amount of one input may be traded off against the amount of the other.We refer to the slope as the marginal rate of technological substitution (MRTS) when the negative sign is eliminated. The amount by which the input of capital may be decreased when one more unit of labour is utilised while maintaining the same level of output is known as the marginal rate of technological substitution of labour for capital. This is comparable to consumer theory's marginal rate of substitution (MRS).

Returns to Scale

Our examination of input replacement throughout the manufacturing process has shown what occurs when a business switches out one input for another while maintaining output. In the long term, however, with all inputs being changeable, the company must also think about the best strategy to boost production. Changing the operation's size by proportionally raising all of the production's inputs is one technique to do this. What will happen to production if we put two farmers to work with two machines on two acres of land if it takes one farmer using one harvesting equipment on one acre of land to produce 100 bushels of wheat? It is nearly probable that output will rise, but will it double, rise over double, or fall short of doubling? The pace at which output rises when inputs rise proportionally is known as the return to scale. Three scenarios—increasing, steady, and decreasing returns to scale.

DISCUSSION

Avoidance of Returns to Scale

There are growing returns to scale if output increases by more than a factor of two when inputs are doubled. This might be the result of the activity being carried out at a greater scale, which enables managers and employees to specialise in their job and use larger, more advanced factories and equipment. The car assembly line is a well-known illustration of growing returns.From the standpoint of public policy, the possibility of rising returns to scale is a significant concern. If returns are rising, it is more beneficial from an economic standpoint to have one big business producing (at a relatively low cost) as opposed to numerous small enterprises (at a relatively high cost). This major company may need to be controlled since it can dictate the price it sets. For instance, one of the reasons we have big, regulated power corporations is because of the rising profits in the supply of energy.

Returns To Scale Constantly

Regarding the volume of production, a second option is that if inputs are doubled, output may also double. We claim that there are consistent returns to scale in this situation. The productivity of the firm's factors is unaffected by the size of the operation due to consistent returns to scale:Two plants may generate twice as much since it is simple to duplicate one plant using a certain manufacturing method. For instance, a big travel agency could provide the same level of service to each customer and employ the same proportion of capital (office space) and labour (travel agents) as a small agency that caters to fewer customers[4]–[6].

Describing Returns to Scale

Returns to scale do not always have to be constant at every level of output. For instance, the company can see growing returns to scale at lower production levels but steady and finally declining returns at higher output levels.In the two sections the existence or lack of returns to scale is shown visually. Each panel's line 0A from the origin represents a manufacturing process where capital and labour are employed as inputs to create varying amounts of output in a ratio of 5 hours of labour to 2 hours of machine time. The firm's production function shows consistent returns to scale. 10 units are produced after 5 hours of manual labour and 2 hours of machine time. The output increases by 10 to 20 units when both inputs are doubled; by 10 to 30 units when both inputs are tripled. To put it another way, it takes twice as much of both inputs to make 20 units and three times as much to make 30 units.

Now that we are travelling along 0A away from the origin, the isoquants are becoming closer together. As a consequence, to boost output from 10 to 20 units, less than twice as much of both inputs is required; to make 30 units, much less than three times as much is required. If the production function (not depicted here) had diminishing returns to scale, the opposite would be true. The isoquants get more and more separated from one another as production levels rise proportionately with declining returns.Returns to scale differ significantly across businesses and sectors. Generally speaking, bigger enterprises in an industry tend to exist where returns to scale are higher. Manufacturing sectors are more likely to see growing returns to scale than service-oriented companies since manufacturing requires significant capital equipment expenditures. Services often need more labour and may be delivered just as effectively in small amounts as they can on a big scale**.**

Economic Cost versus Accounting Cost

Financial accountants are often concerned with keeping track of assets and obligations and reporting previous performance for external use, such as in yearly reports, but economists have a different perspective on cost. Financial accountants often evaluate the business's activities and finances in the past. Because of this, accounting cost, which financial accountants use to quantify costs, may or may not include elements that economists would often include. For capital equipment, depreciation charges are added to real costs as part of accounting cost, which is calculated based on the Internal Revenue Service's permissible tax treatment.Economists adopt a forward-looking perspective, as do managers, we hope. They are worried about how to distribute limited resources. They are thus interested in what expenses are anticipated to be in the future and how the company may be able to reorganise its resources to save costs and increase profitability.

We will see that this is why economists are interested in economic cost, which is the price of using resources for manufacturing. Which resources fall under the category of economic cost? The term "economic" instructs us to make a distinction between expenses that the company can control and those that it cannot. It also advises us to take into account all production-related expenses. Clearly resources like as labour, capital, and raw materials should have their costs taken into account. However, the company could also consume resources with less evident but equally significant consequences. Opportunity cost is a key idea in this situation.

Opportunity Cost

Opportunity cost is the price incurred when opportunities are lost because the firm's resources are not put to their best alternative use. An example will help you to grasp this the simplest. Consider a business that owns a structure and doesn't have to pay rent for office space. Does this imply that office space is free of charge? Although the accountant and management of the company could concur, an economist would disagree. The economist would point out that the business might have rented out its office space and made money doing so. Leasing the office space would have meant putting this resource to another use, one that would have brought in rental money for the company. The potential cost of using the office space is this skipped rent. Additionally, because the company is using the office space as a resource, this opportunity cost is also a financial expense of doing business.

What about the wages and salaries that the company's employees receive, if you give it some thought, you'll see that this is not just an economic expense of running company but also an

opportunity cost. The argument is that the money given to the employees might have been used in a different way. Maybe the company might have utilised some or all of that money to purchase additional labor-saving equipment or even to create a whole other product.Although the terms "economic cost" and "opportunity cost" refer to the same thing, the latter term is more relevant in circumstances when forgone options do not correspond to monetary expenditures. Let's examine opportunity cost in further depth to see how it might cause economic cost to diverge from accounting cost in how salaries are handled and then in the cost of manufacturing inputs.

Think about a business owner who runs her own toy shop without receiving a wage. For the sake of clarity, we'll ignore the rent she pays for the office space. Our toy business owner might have found a job that earned $60,000 year for roughly the same effort if she had decided to work somewhere else. The potential cost of her time working for her toy shop in this instance is $60,000. Now imagine that she spent $1 million last year to purchase a toy inventory. She anticipates being able to recoup a sizable portion of her initial investment by selling those toys throughout the Christmas season. She does, however, get a $1.5 million bid early in the autumn from another toy merchant to buy their inventory. Should she dispose of her stock? The response is influenced by her company's prospects in part, but also by the opportunity cost of buying a toy inventory. The potential cost of retaining it is $1.5 million, not the $1.0 million she initially paid, assuming it would cost $1.5 million to buy the new inventory all over again[7]–[9].

Given that the opportunity cost is equal to the difference between the market value of the inventory and the cost of acquiring it ($500,000), one could wonder why it isn't simply that amount. The important thing is that the owner must decide what would work best for her firm going forward when determining what to do with the inventory. In order to achieve this, she must take into consideration the fact that, if she maintains the inventory for her personal use, she would forfeit the $1.5 million she might have made by selling the stock to another company

Be aware that an accountant may not see the situation this way. The accountant may inform the owner of the toy business that using the inventory will only cost her the $1 million she spent on it. However, we hope you can see why this would be false. The $1.5 million that the owner might have made by selling the goods to another merchant instead represents the true economic cost of holding and using that inventory.There are situations when accountants and economists consider depreciation differently. Economists and managers are worried about the capital cost of equipment and machinery when assessing the future profitability of a corporation. This cost includes both the initial financial investment for purchasing and operating the equipment as well as the cost of wear and tear. To estimate permissible depreciation in their cost and profit calculations, cost accountants employ tax regulations that apply to broadly defined classes of assets when assessing previous performance. However, these depreciation allowances are not required to account for real equipment wear and tear, which would likely vary from asset to asset[10].

CONCLUSION

Understanding and improving economic performance depend on determining labour productivity. Stakeholders may find solutions to increase labour productivity by taking into account elements including technology breakthroughs, investments in human resources, labour management, infrastructure, and legislative frameworks. Achieving sustainable economic development, raising living standards, and sustaining competitiveness in a globalised economy all depend on increasing labour productivity.This research project intends to analyse how labour

productivity is determined, explore the major elements that affect it, look at various measuring techniques, and look at approaches for increasing labour productivity. A key indication of efficiency and output per unit of labour input in diverse areas is labour productivity. The neoclassical production function, the human capital theory, and technological improvements are only a few of the ideas and models examined in the research. It looks at things like education and skill level, technology advancement, work organisation, management strategies, and employee motivation that have an influence on labour productivity. The study also examines other ways to gauge labour productivity, such as output-based metrics, value-added measurements, and multi-factor productivity measures. It also looks at various methods and interventions for raising labour productivity, including workforce development and training, technology adoption, process enhancements, and incentive programmes. This research offers insights into how labour productivity is determined and assists companies and politicians in making fact-based decisions via empirical analysis, case studies, and theoretical frameworks.

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CHAPTER 12

ANALYSIS OF FIXED COSTS AND VARIABLE COSTS

Dr. Mounica Vallabhaneni
Assistant Professor, Department of Commerce and Economics,
Presidency University, Bangalore, India.
Email Id:mounicav@presidencyuniversity.in

ABSTRACT:

the examination of the definitions, traits, and effects on operations and decision-making of fixed costs and variable costs in economics. The differences between fixed and variable costs, their link to production volume, and their impact on cost structures and profitability are all examined in the research. For managers, entrepreneurs, and policymakers to optimise resource allocation, pricing strategies, and overall company success, it is crucial to comprehend the dynamics of fixed costs and variable costs.

KEYWORDS:

Enhancement Strategies, Factors, Measurement, Labor Productivity, Workforce Development.

. INTRODUCTION

While certain expenses fluctuate as a result of production, others are constant regardless of whether the company is creating any output at all. This difference will be crucial when we evaluate the firm's output strategy for maximising profits in the next chapter. As a result, we separate the overall economic cost of manufacturing, or total cost (TC or C), into two parts.Fixed cost (FC): A cost that does not change based on the quantity of output and that can only be eliminated by ceasing operations. A cost that changes as output changes is called a variable cost (VC).Depending on the situation, fixed costs can include expenses for maintaining the plant, insurance, heat and power, and perhaps a small staff. No matter how much production the company creates, they stay the same. As output rises, variable costs, which include expenses for employees, salaries, and raw materials utilised in manufacturing, rise as well.Fixed costs are expenses that are constant regardless of production level and must be covered even when there is none. A company can only get rid of its fixed expenses by closing down[1]–[3].

Winding Down

Going out of business isn't always the result of a shutdown. Consider a scenario in which a textile firm with many factories wishes to minimise production and expenses at one of its facilities due to diminishing demand. The corporation could reduce the expenses of raw materials and much of the labour by shutting down that plant, but it would still be responsible for the fixed costs of paying the management, security personnel, and continuing upkeep. The only option to get rid of such fixed expenses is to shut down operations, stop using the power, and maybe even sell or scrap the equipment.

The business would continue, and the firm could run its surviving plants. It may even be possible to reopen the plant it had shut down, but doing so could be expensive if it required investing in new equipment or repairing the existing equipment.How can we distinguish between fixed and

variable costs? The response depends on the time frame we are using.Most expenditures are fixed for a fairly limited time frame, like a few months. No of how much or how little a company produces during such a short time, it is typically required to pay for contractual shipments of supplies and cannot simply lay off employees.

On the other hand, as time goes on let's say over the course of two or three years—many expenses start to fluctuate. If the company wishes to lower its production throughout this time period, it may do so by reducing its personnel, buying fewer raw materials, and possibly even selling off part of its gear. Nearly all expenses are variable over a very long time horizon, like 10 years. The employment of employees and managers may be decreased via attrition or layoffs, and most of the equipment may be auctioned off or left in place as it ages and is scrapped.

For the management of a business, it is critical to understand which expenses are fixed and which are variable. A company will want to know how changing its output would impact its expenses before increasing or decreasing it. Think of a challenge that Delta Air Lines encountered, for instance. In order to see how company expenses might change, Delta decided to cut the number of its scheduled flights by 10%. Whether we are looking at the long run or the short run will determine the answer. Schedules are established throughout the near term—let's say six months—making it difficult to fire or lay off employees. Because of this, the majority of Delta's short-term expenses are set and won't be greatly decreased by the fewer flights. Long term, let's say two years or more, the situation is quite different. Delta has enough time to let unnecessary employees go and to sell or lease unused aircraft. Since most of Delta's expenses in this situation are determinable, a 10-percent flight reduction would considerably lower expenditures.

Fixed versus Sunk Costs

Sunk costs and fixed costs are sometimes confused. As we just saw, fixed costs are expenses incurred by a functioning business, regardless of the volume of product it generates. Such charges might, for instance, include the wages of the principal executives, the cost of their offices and administrative help, insurance, and plant upkeep expenses. If the company closes a factory or ceases operations, fixed expenses may be minimised since senior executives and their support workers, for instance, are no longer required.On the other hand, sunk costs are expenses that have been paid but cannot be recouped. A pharmaceutical corporation could incur R&D expenses to create and test a new medicine, and then, if the drug is found to be both safe and effective, marketing expenses. These expenses can't be recovered and are thus irrecoverable regardless of the drug's success or failure. Another example is the price of a chip-fabrication facility that makes computer microprocessors.

Most if not all of this expense is buried, or cannot be recovered, since the plant's equipment is too specialised to be used in any other business. If the equipment is sold for scrap, (a very tiny portion of the cost) could be recovered.Contrarily, imagine if a business had promised to contribute to an employee retirement plan every year for as long as it was in business, regardless of how much it produced or how profitable it was. The only way these payments could stop is if the company closed down. The payments in this situation should be considered a fixed expense.Why are fixed costs and sunk costs different? because sunk expenses have no impact on the firm's actions in the future, but fixed costs do. A company may have to close its doors if its fixed expenses are too high in relation to revenue and cannot be decreased; removing those fixed costs even when no profit is made can be preferable than continuing to lose money. High sunk

costs may subsequently prove to be a mistake (for instance, the failed development of a new product), but the money has already been spent and cannot be recouped by closing down.

DISCUSSION

The Determinants of Short-Run Cost

The structure of the manufacturing process, in particular how much of it includes declining marginal returns to variable components, determines the pace at which these costs rise. Remember from Chapter 6 that decreasing labor's marginal output is accompanied by declining marginal returns. What happens when the firm's production increases if labour is the sole input? The business needs employ additional workers in order to increase production. If the marginal product of labour declines with an increase in the quantity of labour engaged (due to diminishing returns), then as the rate of production rises, progressively higher expenditures must be paid. On the other hand, costs won't grow as rapidly when the rate of production increases if the marginal product of labour just marginally declines as labour input increases.

Equipment, structures, and other capital needed in the manufacturing process are often rented or leased by businesses. At other times, the capital is bought. However, even if capital was acquired, it will be helpful to analyse it as though it were leased. An example will assist to clarify how and why we carry out this action.Assume Delta Airlines is considering spending $150 million on a brand-new Boeing aircraft. Even though Delta would pay a significant amount for the jet immediately, the purchase price may be divided or amortised throughout the life of the aircraft for financial reasons. As a result, Delta will be able to compare its yearly flow-based revenues and expenses. Assuming a 30-year lifespan for the aircraft, the amortised cost works out to $5 million year. The $5 million might be thought of as the plane's yearly economic depreciation[4]–[6].We have so far dismissed the possibility that the company might have earned interest on its $150 million if it hadn't bought the aircraft. This lost interest is an opportunity cost that has to be taken into consideration. The annual cost of owning and using the aeroplane, as opposed to selling it or never purchasing one in the first place, is therefore determined by adding the economic depreciation and the interest (i.e., the potential financial return) that could have been earned had the money been invested somewhere else.

The Cost-Minimizing Input Choice

a basic issue that all businesses encounter: how to choose inputs to create a specific output at the lowest possible cost. For the sake of simplicity, we will only utilise two input variables: labour measured in work hours per year and capital measured in machine use hours per year.The cost of these inputs will, of course, affect how much labour and capital the company consumes. We will assume that both inputs' pricing are unaffected by the actions of the company since there exist competitive marketplaces for each of them. In this instance, the cost of labour is represented by the wage rate, w.

The Cost Of Capitalism

The business might change how much capital it consumes over time. Even if the capital comprises specialised equipment with no alternative application, costs for this equipment have not yet been incurred and must be taken into consideration when the business determines how much capital to get in the future. However, significant upfront capital expenditures are required, unlike labour costs.We wish to characterise this capital expenditure as a flow for example, in

dollars per year in order to compare the firm's capital investment with its continuing cost of labour. To do this, we must spread the cost out across the capital's lifespan and account for the interest that would have been lost had the company invested the money elsewhere. This is precisely what we do when we determine the user cost of capital, as we just saw. As stated before, the user cost of capital is determined by the depreciation rate, or r. rate of interest.

The Rate Of Capital Rent

As we said, renting rather than buying capital is common. A huge office building's office area serves as an illustration. The cost of renting a unit of capital is what is being referred to as the price of capital in this instance, or its rental rate. Does this imply that when calculating the cost of capital, we must make a distinction between capital that is leased and capital that is purchased? No. The rental rate ought to be equal to the user cost, r, if the capital market is competitive, as we have imagined it to be. Why? Because businesses that own capital like the owner of the big office building anticipate making a competitive return when they rent it out specifically, the rate of return they could have made by investing their money elsewhere plus a sum to account for the depreciation of the capital in a competitive market. The user cost of capital is this competitive return.

Simply put, a lot of textbooks assume that all capital is leased out at a rental rate r. This assumption is fair, as we just saw. But now you need to know why it is reasonable: It is possible to treat acquired capital as if it were being leased at a monthly fee equal to the capital's usage cost. We shall thus assume for the rest of this chapter that a business leases all of its capital at a rental rate, or "price," r, just as it employs labour at a wage rate, or "price," w. We'll also assume that businesses see any sunk capital costs as a fixed expense that is incurred over time. Therefore, we do not need to worry about sunk expenses. Instead, we may now concentrate on how a company considers these pricing when deciding how much capital and labour to employ.MPL /w is the extra production that is produced when labour costs are increased by $1. Assume that the hourly salary is $10 and that adding a worker to the manufacturing process would result in a 20-unit increase in output. 20/10 = 2 units of production per dollar will be produced more when a dollar is spent on a second worker. The extra production that occurs from adding another dollar to the capital budget is known as MPK/r. Therefore, according to equation (7.4), a company that wants to save costs should set its input amounts such that every dollar that is added to the manufacturing process results in an equal amount of additional output.

Why is this need necessary for cost minimization? Assume that the capital rental rate is $2 in addition to the $10 wage rate. Assume that increasing capital by one unit will result in a 20-unit increase in production. In such scenario, the extra production would be 20/$2 = 10 units of output for dollar of capital input. The company will want to utilise more capital and less labour since a dollar invested in capital is five times more productive than a dollar invested in labour. The firm's marginal product of labour will grow and its marginal product of capital will decrease if it cuts labour and raises capital. There will come a time when producing an extra unit of output will cost the same regardless of the additional input utilised. The company is then minimising its expense.

Cost Minimization with Varying Output Levels

In order to create a certain level of output, a cost-minimizing company chooses a mix of inputs. We now broaden this research to examine how the firm's expenses relate to its level of

production. In order to achieve this, we first compute the cost of the firm's input quantities that minimise its costs for each output level.

The outcome of the cost-minimization exercise We've presummated that the company may rent a capital K unit for r = $20/hour and employ labour L for w = $10/hour. We have created three of the firm's isocost lines using these input costs. The following equation yields each isocost line:

C = ($10/hour for L) + ($20/hour for K)

The lowest (unlabeled) line (a) corresponds to a cost of $1,000, the middle line to $2,000, and the top line to $3,000.Each of the three locations A, B, and C represents a point of tangency between an isoquant and an isocost curve, as can be seen. For instance, Point B demonstrates that the cheapest method to generate 200 units of output is to employ 100 units of labour and 50 units of capital, which results in a cost that is on the isocost line of $2000.Similar to this, at point A, L = 50, K = 25, the least expensive method to make 100 units of output (the lowest unlabeled isoquant) is $1000; at point C, L = 150, K = 75, the least expensive way to get 300 units of output is $3000[7]–[9].

The expansion route of the firm is the curve that traverses the points of tangency between its isocost lines and isoquants. The growth route outlines the capital and labour allocations the company will choose to cut costs at each output level. The curve will be upward sloping as long as production increases the usage of both labour and capital. We can quickly determine the line's slope in this specific instance. Capital grows from 25 to 50 units as production goes from 100 to 200 units, while labour goes from 50 to 100 units. The business requires half as much capital ait does labour for each level of production[10].

CONCLUSION

Insights into the cost structure and profitability of firms may be gained through the examination of fixed and variable expenses. Managers, business owners, and politicians may choose resource allocation, pricing tactics, and company performance wisely by comprehending the features and dynamics of fixed costs and variable costs. Fixed costs are outlays that are constant irrespective of the output or volume of production. They consist of costs like rent, wages, and insurance payments. Fixed costs are unaffected by short-term production variations and are generally steady over time. Even when there is no manufacturing or sales activity, these expenses are incurred.

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CHAPTER 13

DETERMINATION OF LONG-RUN AVERAGE COST

Mr. Yelahanka Lokesh
Assistant Professor, Department of Commerce and Economics,
Presidency University, Bangalore, India.
Email Id: lokesh.yr@presidencyuniversity.in

ABSTRACT:

The study of long-run average cost in economics, including the idea, variables that affect it, and how it affects business decisions. The research looks at economies of scale, diseconomies of scale, and the impact of technology. It also looks at the link between production levels and long-run average cost. Managers, businesspeople, and politicians must understand how to calculate long-run average costs in order to maximise output and cost effectiveness.

KEYWORDS:

Cost Efficiency, Diseconomies, Economies, Long-Run Average Cost, Production Levels, Technology.

INTRODUCTION

The capacity to alter capital requirements ultimately enables the company to save expenses. We may look at the long-run average and marginal cost curves to understand how costs change as the business expands over time.The link between the size of the firm's operation and the inputs needed to minimise its costs is the most significant factor in determining the form of the long-run average and marginal cost curves. Consider the case when the manufacturing process of the company displays consistent returns to scale at all input levels. In this instance, doubling the inputs causes the output to double. The average cost of production must be constant across all levels of output since input costs do not vary as output rises. Instead, suppose that the firm's manufacturing method is impacted by growing returns to scale: More than twice as much output results from double the inputs.In such scenario, the average cost of production decreases as output increases since a cost doubling is accompanied by a gain in output that is more than a factor of two. By the same reasoning, the average cost of production must rise along with output when there are declining returns to scale.

We observed that the growth path's long-term total cost curve was a straight line from the origin. The long-run average cost of manufacturing in this constant-returns-to-scale example is constant: It doesn't alter when production rises. The long-term average cost is $1000/100, or $10 per unit, for an output of 100. Long-term average cost for an output of 200 is $2000/200, or $10 per unit; average cost for an output of 300 is equally $10 per unit. The long-run average and marginal cost curves are provided by a horizontal line at a cost of $10 per unit since a constant average cost implies a constant marginal cost[1]–[3].

Remember that we looked at a firm's production technology in the previous chapter that first showed growing returns to scale, then constant returns to scale, and finally declining returns to scale. A typical long-run average cost curve (LAC) in line with this explanation of the manufacturing process. The long-run average cost curve (LRAC) has a U-shape similar to the

short-run average cost curve (SAC), but rather than declining returns to a component of production, the U-shape is caused by growing and decreasing returns to scale.The long-run marginal cost curve (LMC), which tracks the shift in long-run total costs as production is gradually raised, may be calculated from the long-run average cost curve. When the long-run average cost curve (LAC) is decreasing, LMC is below it; when it is increasing, LMC is above it.10 The long-run average cost curve reaches its lowest at A, where the two curves converge. LAC and LMC are equivalent in the specific scenario in which LAC is constant**.**

Economies and Diseconomies of Scale

The average cost of production for the company is expected to go down as output rises, at least to a certain degree. The following causes for this include:

1. Employees may specialise in the tasks at which they are most productive if the company runs on a greater scale.
2. Scale may provide adaptability. Managers may more efficiently organise the production process by changing the mix of inputs used to generate the firm's output.
3. The company may be able to purchase certain manufacturing inputs for less money since it is purchasing them in bulk and can therefore bargain for cheaper costs. If managers use cheaper inputs, the mix of inputs may alter as the firm's operations grow in size.

However, it is probable that the average cost of manufacturing will start to rise along with output at some time. Three factors account for this change:

1. At least in the short term, the physical layout and equipment of factories may make it more difficult for employees to do their duties well.
2. As the number of responsibilities rises, management of a bigger company may become more difficult and ineffective.
3. Once a particular threshold is achieved, the benefits of purchasing in bulk may have vanished. The availability of critical inputs may eventually be constrained, increasing the cost of those inputs.

We must acknowledge that when input proportions do vary, the firm's growth route is no longer a straight line and the idea of returns to scale no longer holds true in order to analyse the link between the size of the firm's operation and the firm's expenses. Instead, when a company can double its production for less than twice the cost, we claim that it has achieved economies of scale. When a doubling of production requires more than a doubling of cost, diseconomies of scale result. Although growing returns to scale is a specific instance of economies of scale, the phrase itself refers to input proportions that alter when a business adjusts its level of output. In this more comprehensive context, the company faces economies of scale at relatively low production levels and diseconomies of scale for larger ones, as shown by a U-shaped long-run average cost curve.Consider a dairy farm to understand the distinction between economies of scale where input proportions are variable and returns to scale where inputs are utilised in consistent proportions as output increases. Land, machinery, cows, and feed all play a role in milk production. A dairy farm with 50 cows will employ a combination of inputs that is heavier on labour than on machinery cows are milked by hand, for example. A farm with 100 cows could double its milk output if all inputs were doubled. The farm with 200 cows will have the same situation, and so forth. There are continual returns to scale in this situation.However, large dairy farms have the choice to use milking machines. No matter how big the farm is, consistent returns

would still be true if a big farm kept milking cows by hand. However, the farm shifts its technique to the use of machines as it goes from 50 to 100 cows, which allows it to lower its average cost of milk production from 20 cents per gallon to 15 cents per gallon. There are economies of scale in this situation.

DISCUSSION

The Relationship between Short-Run and Long-Run Cost

The connection between short-term and long-term costs. Assume that a company is weighing three different plant sizes since it is unsure about the future demand for its product. SAC1, SAC2, and SAC3 provide the short-run average cost curves for the three plants. The choice is crucial since, after the plant is completed, the company may not be able to adjust the plant size for a while.The scenario where there are three alternative plant sizes is The smallest plant should be constructed if the company anticipates producing q 0 units of output. Its manufacture would cost $8 on average. (If it chose to create output q1 at that point, its short run average cost would remain $8.) The middle-sized plant is ideal if it plans to produce in the second quarter, however. Similar to this, the biggest of the three plants would be the most effective option with an output of q3. What is the long-run average cost curve for the company? Long-term, the company has the ability to alter the scale of its factory. Thus, it will always choose the facility with the lowest overall cost of manufacturing.Because they display the lowest cost of production for each output level, the crosshatched areas of the short-run average cost curves are what make up the long-run average cost curve. The short-run average cost curves' envelope, or the area around which they are surrounded, is the long-run average cost curve.

Now imagine that there are several plant size options, each with a unique short-run average cost curve. Once again, the envelope of the short-run curves equals the long-run average cost curve. It is the LAC curve. The size of the plant as well as the ratio of capital to labour that enables the company to produce everything it wants to at the lowest possible average cost may be chosen.At lower production levels, the long-run average cost curve initially shows economies of scale, but at greater output levels, it shows diseconomies.Consider a company that wishes to create output q1 in order to better understand the link between short-run and long-run cost curves. The SAC1 short-run average cost curve is significant if it constructs a small plant. At B on SAC1, the average manufacturing cost is $8. A small facility with an average cost of production of $10 is preferable to a medium-sized unit with same cost (A on the SAC2 curve). Thus, if only three plant sizes are allowed, Point B would move up one point on the long-run cost function. B would no longer be on the long-run cost curve if facilities of different sizes could be constructed, and if at least one size enabled the company to manufacture q1 for less than $8 per unit.

The U-shaped envelope that would result from the ability to construct plants of any size. Recall that none of the short-run average cost curves are ever above the LAC curve. Also keep in mind that the lowest average cost points of the smallest and biggest plants do not sit on the long-run average cost curve due to long-term economies of scale and diseconomies of scale. A big factory may benefit from increased returns to scale to produce at a reduced average cost, hence a small plant running at minimal average cost is not efficient.Finally, keep in mind that the short-run marginal cost curves' envelope is not the long-run marginal cost curve LMC. Long-run marginal costs apply to all potential plant sizes, but short-run marginal costs only apply to a specific plant. The short-run marginal cost for the plant with the highest cost-effectiveness is represented by

each point on the long-run marginal cost curve, SMC1 crosses LMC at the output level q0 where SAC1 is tangent to LAC, supporting this connection.

Production with Two Output Economies of Scope

Many businesses create many products. The products of a corporation may sometimes be closely related to one another. For instance, a chicken farm produces chicken and eggs, an automotive manufacturer provides cars and trucks, and a university generates both teaching and research. Other times, businesses create items that are physically unconnected. However, in all scenarios, a company that manufactures two or more items is likely to have cost or production benefits. These benefits can be the result of shared input or manufacturing facility utilization, combined marketing initiatives, or even cost savings from a single administrative structure. In certain instances, the creation of one product results in the automated and inevitable production of a valuable byproduct for the company. For instance, scrap metal and shavings are produced by sheet metal factories and sold.

Product Transformation Curves

Consider a vehicle firm that manufactures both tractors and automobiles as we examine the financial benefits of joint manufacturing. Both goods rely on labour and capital (factories and equipment) as inputs.

Tractors and cars are normally not made in the same factory, although they do share managerial resources and depend on the same equipment and trained labour. The quantity of each product to be produced must be determined by the company's management. demonstrates two product transformation curves, one for each possible combination of tractors and automobiles that may be produced with a certain input of labour and equipment[4]–[6].

With relatively few inputs, curve O1 depicts all the combinations of the two outputs, whereas curve O2 explains the output possibilities that result from using twice as many inputs.Why is there a negative slope on the product transformation curve? Because the company must give up part of the other production in order to get more of one output. For instance, a company that prioritises the manufacturing of cars would spend less on making tractors. shows that curve O2 is twice as far away from the origin as curve O1, indicating that both commodities are produced via this firm's production process with continuous returns to scale.

Joint production would result in no profits (or losses) if curve O1 were a straight line. The production from two smaller businesses, one specialising in tractors and the other in automobiles, would be equivalent to that of one large business manufacturing both. However, joint production often provides benefits that allow a single business to create more cars and tractors with the same resources as would two companies manufacturing each product independently, therefore the product transformation curve is bent outward (or concave). The shared use of inputs is a component of these production benefits. For instance, a single management is often more equipped than several managements to plan and coordinate production as well as manage accounting and financial tasks[7]–[9].

Economies and Diseconomies of Scope

Generally speaking, economies of scope exist when the combined output of a single business exceeds the output that two separate companies producing the same product (with similar

production inputs distributed between them) might produce. When a firm's combined output is lower than what other enterprises might produce alone, diseconomies of scope are present in the production process.If the creation of one product somehow interfered with the production of the second, this potential may materialise.

Economies of scale and economies of scope are not directly related to one another. Even though its manufacturing process entails diseconomies of scale, a two-output business may nevertheless benefit from economies of scope. Let's say, for instance, that making flutes and piccolos together is less expensive than doing it individually. However, the manufacturing process requires highly specialised labour and is best successful when carried out on a small scale. Similarly, a joint-product company may have scale economies for each specific product while not experiencing scale economies overall. Consider a major conglomerate that owns a number of businesses that operate profitably on a vast scale but are managed independently, preventing them from using economies of scale[10].

Learning versus Economies of Scale

The full impact of the learning curve would be felt until the company had produced 20 or more machine batches, at which point we could do the customary cost study. However, if the manufacturing method were very recent, relatively high costs at low output levels (and relatively cheap costs at higher ones) would point to learning effects rather than economies of scale. Regardless of the size of the firm's operation, a mature firm's cost of production is generally low with learning. If a company that manufactures machine tools in lots is aware that it benefits from economies of scale, it should manufacture its machines in very big numbers to benefit from the reduced cost related to size. If there is a learning curve, a company will have an excessively negative perspective of the business if it solely considers the high initial labour need. Assume the company intends to operate for a very long period and produce 10 units annually. Assume that 10 people will be needed in total for production throughout the first year. The firm's costs will be high during the first year of production as it learns the industry. The learning effect will eventually take hold, however, and manufacturing costs will decrease. After 8 years, just 5.1 workers will be needed to make 10 units, and the cost per unit will be nearly 50% lower than it was in the first year of production. As a result, when a company is determining whether to join a market, the learning curve might be crucial.

CONCLUSION

For corporate operations to be as productive and cost-effective as possible, the assessment of the long-run average cost is essential. Managers, entrepreneurs, and politicians may make well-informed choices on production levels and cost optimization by being aware of the variables affecting long-run average cost, such as economies of scale, diseconomies of scale, and technical improvements. Businesses may improve their competitiveness, create sustainable growth, and maximize profitability by attaining cost efficiency and determining the best size of production.relatively high costs at low output levels (and relatively cheap costs at higher ones) would point to learning effects rather than economies of scale. Regardless of the size of the firm's operation, a mature firm's cost of production is generally low with learning. If a company that manufactures machine tools in lots is aware that it benefits from economies of scale, it should manufacture its machines in very big numbers to benefit from the reduced cost related to size.

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